Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	**)**
	)
The Commission's Cable Horizontal and Vertical	**) MM Docket No. 92-264**
Ownership Limits and Attribution Rules	**)**

COMMENTS
of
CONSUMER FEDERATION OF AMERICA ,
CONSUMERS UNION
and
FREE PRESS

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I. SUMMARY

A. COMMENTERS

In these comments the Consumer Federation of America, Consumers Union, and Free Press provide a thorough review of how the structure of the cable dominated multi-channel video programming distribution (MVPD) industry results in increased consumer prices, impedes development of independent programming and reduces consumer choice.

The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, composed of two hundred and eighty state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than fifty million individual members.[1] Consumers Union (CU), publisher of Consumer Reports, is an independent, nonprofit testing and information organization serving only consumers. Free Press is a national nonpartisan organization with over 200,000 members working to increase informed public participation in crucial media policy debates.

CFA and CU have participated in the earlier rounds of this proceeding.[2] They have also been participated in virtually every proceeding dealing with the cable industry in the past two decades including merger reviews[3] and public policy proceedings.[4]

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[1] CFA is online at www.consumerfed.org; CU is online at www.consumersunion.org; Free Press is online at www.freepress.net

[2] "Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, The Office of Communications of the United Church of Christ, Inc., National Association of Telecommunications Officers and Advisors, Association for Independent Video Filmmakers, National Alliance for Media Arts and Culture, and the Alliance for Community Media," *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules, Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS

B. THE FCC HORIZONTAL LIMITS PROCEEDINGS

In the *Cable Consumer Protection and Competition Act of 1992*, Congress concluded that placing a limit on the number of homes that a single owner could pass on a nationwide basis would limit that owner's power to unfairly impede the flow of programming to the public. It is now clear that such a limit, particularly if it also simultaneously limits the ownership of regional clusters of cable systems in critical markets, could also serve to reduce the harm that consumers suffer at the hands of the cable industry by lowering the barriers to entry of other video distribution platforms.

Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154; January 4, 2002; "Reply Comments of the Consumer Federation of America, Consumers Union, Center for Digital Democracy, and Media Access Project," 2003; Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules, Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154.

[3] Consumer Federation of America, "Petition to Deny of Arizona Consumers Council, Association Of Independent Video And Filmmakers, CalPIRG, Center For Digital Democracy, Center For Public Representation, Chicago Consumer Coalition, Civil Rights Forum On Communications Policy, Citizen Action Of Illinois, Consumer Action, Consumer Assistance Council, Consumer Federation Of America, Consumer Fraud Watch, Consumers United/Minnesotans For Safe Food, Consumers Union, Consumers' Voice, Democratic Process Center, Empire State Consumer Association, Florida Consumer Action Network, ILPIRG (Illinois), Massachusetts Consumers Coalition, MassPIRG, Media Access Project, Mercer County Community Action, National Alliance For Media Arts And Culture, MontPIRG, New York Citizens Utility Board, NC PIRG, North Carolina Justice And Community Development Center, OsPIRG(Oregon State), Oregon Citizens Utility Board, Texas Consumer Association, Texas Watch, United Church Of Christ, Office Of Communication, Inc., US PIRG, Virginia Citizens Consumer Council, WashPIRG, Wisconsin Consumers League, " *In the Matter of Application for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors, to AT&T Comcast Corporation, Transferee,* April 29, 2002; "Petition to Deny of Consumer's Union, Consumer Federation of America, Media Access Project, and Center for Media Education." *In the Matter of Application of America Online Inc. and Time Warner, Inc. for Transfers of Control*, Federal Communications Commission, CS-Docket No. 0030, April 26, 2000.

[4] "Comments and Reply Comments of Consumers Union and the Consumer Federation of America," *In the Matter of Comments Requested on a La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems,* before the Federal Communications Commission, MB Docket No. 04-207, July 13, 2004, August 13, 2004 "Comments of MB Docket No. 04-207; "Comments of the Consumer Federation of America," before the Federal Communications Commission, In the Matter of Implementation of Sections of the Cable Television Consumer Protection Act of 1992, MM Docket No. 92-266, January 27, 1993.

Because the Commission did a poor job in justifying its past rules and then allowed the current proceeding to lie fallow, more than a dozen years have passed since Congress recognized the important problem of excessive concentration in the industry absent a rigorous limit on concentration. Consumers have seen their monthly bills for basic and expanded basic cable skyrocket, doubling in the past decade. They are forced to buy larger and larger bundles of programs to keep receiving the small number they actually choose to view. Year-after-year, the increase in basic monthly bills fuels increased cash flow in the industry, contradicting claims that programming expenses are driving up price increases. Over this period, cash flow per subscriber per year has increased by 90 percent.

Independent programmers continue to find it difficult if not impossible to gain carriage on cable systems. Year-after-year, independent programmers watch cable operators favor the programs they own by giving them carriage in the basic and expanded basic tiers. Broadcasters, who have been given must-carry and retransmission rights also are far more likely to succeed in gaining carriage on cable systems than an independent programmer. Affiliated programming is nine times as likely to be carried as independent programming in national markets. As a result the same half dozen programmers affiliated with cable operators or broadcasters completely dominate the TV dial, accounting for eighty percent of prime time viewing, programming budgets and cable subscribership. Not one national network has achieved an audience reach of sufficient size to sustain quality programming without being carried on both Comcast and Time Warner systems.

C. A MEANINGFUL LIMIT ON CABLE OWNERSHIP WILL SERVE PROGRAMMERS AND CONSUMERS ALIKE

In short, the failure to adopt a meaningful limit has harmed consumers and programmers. This proceeding has been languishing at the FCC for years while consumers and programmers have suffered. That is why it is captioned a ***Second Further Notice***. Based on this new evidence, elaborated below, the Commission must adjust its horizontal limit policy to address the fact that the current industry structure unfairly impedes the flow of independent programming. A dozen years after the Congress first sought an ownership limit, it is time for the Commission to set one that achieves Congress' intent to ensure independent programmers are not unfairly impeded. It is time for the Commission to take decisive action to begin addressing the persistent problem of the abuse of market power in this industry.

Setting a meaningful horizontal limit on the national reach of cable operators based on an advertising market weighted measure of subscribers would be a major step in the right direction. Concentration of viewers in urban markets should be factored into the horizontal limit calculation, because advertisers value these viewers most. DBS subscribers should be discounted because of the lack of penetration of DBS in major urban markets.

The result of a limit that reflects these realities in the video market would be dramatic. For example, it would require Comcast, which has become the dominant cable operator, not only in size but also in its control of key television markets, to divest significant holdings – four million subscribers. It would force the Commission to conclude that the pending Adelphia-Comcast-Time Warner transaction is not in the public interest.

Setting such a limit would strike a blow at the stranglehold on programming that: 1) perpetuates the dominance of the four broadcast networks, Time Warner and Comcast in the programming market, 2) makes clustering with terrestrial transmission (regional dominance) more effective at limiting competition, and 3) helps all cable companies preserve their monopolistic power to overcharge consumers, a practice we estimate to be in excess of $5 per month, costing consumers billions of dollars per year on an ongoing basis.

D. Overview of the MVPD Market

In this proceeding, following the intent of Congress, the Commission must focus its attention on whether excessive concentration of cable ownership unfairly impedes the flow of independent programming to the public. However, in its Notice, the Commission recognizes that it must examine the patterns of fundamentally anticompetitive conduct throughout the industry to assess whether limits on the reach of a single cable operator (called horizontal limits) will help to prevent such behavior. Therefore, the Commission has asked a wide-ranging set of questions about the basic structure, conduct and performance of the industry.

1. Lack of Competition at the Point-of-Sale

In these comments we show that excessive concentration of ownership is harming consumers and independent programmers (see Exhibit 1). Local market concentration in the industry – the lack of competition at the point of sale – is the key source of market power over both consumer prices and the terms and conditions imposed on programmers for carriage on cable networks.

2. Concentration in the National Video Market

The ability to control programmer access to the consumer by deciding which programs to carry occurs on a market-by-market basis, but as the number and size of the markets controlled increases, the market power over access to consumers translates into market power over programmers as well. Once cable operators become large enough, the refusal to carry programming, or the imposition of onerous conditions of carriage, undermine the ability of the programmer to succeed. Thus the fate of the consumer and the programmer are linked.

3. Clustering of Systems in Regional Markets

Recent developments in the industry have tied the fate of the consumer and the programmer more closely together in another way. The incessant reduction in the number of cable operators and their increasing size has led to the aggregation of cable systems into clusters of systems. As cable operators gain control of large, contiguous geographic areas, their ability to withhold programming they own from other operators increases. They are also more able to obtain exclusive rights to programming they do not own. Restricting the flow of programming to alternative distribution platforms blunts competition at the point-of-sale increasing the cable operator's market power over consumers and programmers. Consumers find that their alternatives for obtaining television service are restricted, while programmers find that their alternatives for distributing programming to the public are restricted.

Concentration in the national market can harm programmers because of inadequate competition at the point-of-sale. Without a well-reasoned rule in place, in the dozen years since Congress acted, the top four firms in the industry have increased their market share from less than half to about two-thirds.[5] The growth of clustered systems has been even more dramatic, from less than one third of all cable subscribers to over four-fifths.[6]

4. Bundling

[5] The Federal Communications Commission, In *the Matter of Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act, (*hereafter referred to as the *First Annual Report*, with all subsequent reports identified by their year number), Table 2 puts the figure at 48 percent. The *Eleventh Annual Report* puts the figure ate 58 percent without attribution of subscribers in partially owned systems and including DBS subscribers in the base. Adding in attribution pushes the figure over 63 percent. Discounting DBS subscribers, as we demonstrate is necessary, would push the figure to two-thirds, or more.

[6] The *Fourth Annual Report* (Table E-2) is the first to show clustering and provides a figure of 20.1 million cable subscribers in clusters for 1994 on a base of 64 million total cable subscribers (Table E-1). The *Eleventh Annual Report* (Table B-2) gives a figure of 53.6 million cable subscribers in clusters on a base of 66.1 million (Table B-1).

Another development that has further restricted consumer choice and programmer access is the cable industry practice of bundling. Cable operators force consumers to buy large bundles of programs in order to obtain the small number of networks that they actually watch. Getting into the bundles that will be widely distributed is a make-or-break threshold for programmers. Access to these bundles is under the control of the cable operator. This practice, which has been prevalent for basic and expanded basic tiers in the past, has recently been extended to digital tiers.

The hope that the expansion of capacity with digital technology would weaken the hold of cable operators has been dashed by the creation of bundles of digital programming. Consumers are forced to buy these bundles if they want the benefits of digital technology. The consumer must now spend about $60 per month and buy about 100 channels in tiers to get digital service. But the typical household watches fewer than twenty channels.

Offering independent programmers the opportunity to sell in the video on demand (VOD) space provides little genuine relief from the stranglehold of the programming cartel. VOD programmers are told to compete for consumer dollars and attention after the cable operators have picked the consumer's pockets and crammed about 100 channels onto the consumer's TV tuner. This is hardly the fair competition for consumer attention that the Congress demanded when it established the objective of this proceeding.

By creating the huge bundles, then controlling which programs are placed in the bundles, cable operators perpetuate their control over consumer pocketbooks and the success or failure of programming. The refusal of cable operators to allow consumers to choose which programs they want to pay for on a program-by-program basis makes it impossible for programmers to sell directly to the public. They must sell themselves, literally and figuratively, to the handful of gatekeepers that control access to the big bundles. Advertisers, looking for national audiences, are unable to refine their message because everybody is forced to pay for everything as a result of cable's bundling strategy. Forced bundling places a premium on carriage on cable systems, in the eyes of the advertisers, rather than actual viewing by the public.

E. THE TIME FOR ACTION IS NOW

In its annual reports on video competition, the FCC opines on the state of the industry, in an attempt to inform Congress about problems that might need action. Unfortunately, the FCC has repeatedly ignored the real experience of consumers and programmers and misleads Congress. There are growing signs that Congress is figuring things out on its own, despite the annual whitewash of the problems that the FCC presents in its reports. Last year Congress demanded that the FCC take a look at one of the lynchpins of cable market power – forcing consumers to buy bundles of programming packaged into tiers in order to receive their favorite channels or to purchase digital services. Unfortunately, this study was yet another whitewash.

Our recommendation on national limits reflects the fact that the underlying structure of marketing in the cable industry is based on the huge bundles of programs the cable operators force on consumers. In a world of genuine consumer choice, the marketing dynamic would be quite different. The reach of programs would be decided not by what cable operators decide to carry, but by what consumer decide to view. We believe that such a world would be much friendlier to consumers and independent programmers. Unfortunately, it is not the world we live in.

Therefore, in these comments we evaluate the issue of horizontal limits in the context of the forced bundling of programming. In that world, setting a much more stringent horizontal limit would be an important step toward ending abuse.

Because this proceeding has languished, the Commission must refresh the record and asks for "new" evidence. The new evidence abounds, as demonstrated below. But the fact that the fundamental problems have not changed much is also extremely important. The remainder of these comments demonstrates the structure, conduct and performance problems we have outlined in this overview. We present new, recent evidence that confirms the analysis we have provided to the Commission in the earlier rounds of this proceeding.

The necessity of a horizontal limit of 20-30% is demonstrated in these comments by economic analysis using the open field approach based on the actions of the two largest firms in the market. This public policy must be in place to guard against collusive price inflation and discrimination against independent programmers. These comments illustrate a variety of anticompetitive behaviors that result from the monopsony power of the largest MSOs—regional clustering and exclusive programming restrictions, price gauging through bundles, and the denial of carriage to programmers unaffiliated with MSOs or broadcasters with retransmission leverage. No national program currently attains the critical threshold of carriage if either of the two largest firms in the industry denies it carriage. Meanwhile, as diversity declines, prices and profits go through the roof. Such outcomes run counter to the intention of Congress and the interests of the public.

II. NEW EVIDENCE THAT OLD ANTICOMPETITIVE PROBLEMS PERSIST IN THE MVPD CABLE INDUSTRY

In the four years since the United State Court of Appeals for the District of Columbia (D.C. Circuit) reversed and remanded the Commission's 30% horizontal limit in *Time Warner Entertainment v. FCC (Time Warner II)*[7] the evidence that cable operators continue to exercise market power at the point of sale to dictate and unfairly impede the flow of video programming to the consumer has continued to mount. Indeed, in the three years since the comment cycle in this proceeding closed, two sets of new evidence have come to light that indicate not only that the horizontal limit should be reinstituted, but that it should be lowered and adjusted to reflect the growth of cable clusters in major urban markets.

A. THE THRESHOLD LEVEL OF PENETRATION FOR SUCCESS OF PROGRAMMING IS HIGHER THAN THE COMMISSION BELIEVED WHEN IT ADOPTED THE 30 PERCENT LIMIT

Confronted with a challenge by Congress to one of the most important tools in their anti-consumer, anti-programmer arsenal--***forced bundling of programming in basic, expanded basic, and digital tiers***--the cable operators have provided data that demonstrates the severe obstacle that independent programmers face in trying to pry through the cable cartel to reach the public.

The cable operators and programmers have argued that in a world that is dominated by linear bundles – large packages of programming tiers that consumers are forced to purchase in order obtain access to the most popular programming or new digital options – a programmer

[7] 240 F. 3d 1126 (D.C. Cir. 2001).

must achieve carriage on systems that pass at least 50 million, and perhaps as many as 75 million, households to achieve long run viability for anything but niche market programming.

A study by Booz Allen Hamilton, commissioned by the National Cable Television Association (NCTA) as the centerpiece of economic analysis for the industry in the a *la Carte* proceeding, was emphatic about this threshold

> Historically, advertisers have been less willing to support networks with less than 50% to 70% coverage of TV households (this threshold is often applied not only to cable but to syndicated broadcast programming). Those advertisers that do support networks before they reach 50% to 70% distribution do so because they want to "get in early" and develop relationships with networks they expect to grow significantly and typically pay lower advertising rates than for established networks.[8]

The figure of 50% to 70% of TV households works out to roughly 54 to 75 million subscribers. Prior statements made in the record of this proceeding that programmers need only achieve relatively low levels of carriage to succeed are directly contradicted by the more recent evidence in the *Cable A La Carte* proceeding. One picture from that proceeding is worth a thousand words as an indicator of the overall market conditions (see Exhibit 2).

Exhibit 2 shows the advertising revenue of the most popular 62 advertiser supported networks. Well over fifty million subscribers appear to be the sharp threshold for achieving substantial advertising revenues. In the world of linear bundling, 50+ million subscribers is a necessary, albeit not sufficient, number of subscribers to achieve substantial revenues. Indeed, a close look at Exhibit 2 suggests that the threshold is actually in the range of 60 million households.

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[8] Booz, Allen Hamilton, *The a la Carte Paradox: Higher Consumer Costs and Reduced Programming Diversity: An Economic analysis of the Implications of al la Carte Pricing on Cable Customers*, July 2004, p. 12.

We noted in our earlier comments that Bravo was struggling to reach 60 million subscribers, a level it deemed necessary to survive as a high quality mass-market offering.[9] Of course, Bravo ultimately was acquired by a broadcast network owner. The America Channel, in a recent filing in opposition in the Adelphia merger proceedings, noted the numerous other statements by cable operators and programmers that reiterate and reinforce this claim [10] A&E reiterates the central challenge identified by Bravo: "in order to attract sufficient advertising revenue to afford to pay for and provide a meaningful quantity of original programming, the network must reach approximately sixty million subscribers."[11] Crown Media Holdings directly refutes the industry claims, reiterated by the Commission, about low levels of subscribers being sufficient.

> Although the Commission has suggested that programming services may survive with a subscriber base of 15 to 20 million subscribers, that is inconsistent with Crown Media's experience in today's marketplace…
>
> The Hallmark Channel's experience suggests that the more realistic plateau of meaningful advertising revenues is now approaching 50 to 60 million subscribers… Thus, these data support the conclusion that substantially greater advertising revenues are available to programming services with up to 50 to 60 million subscribers – a level of subscribership associated with a viable broad-based entertainment programming network in today's competitive marketplace.[12]

We believe that this threshold would be dramatically lowered in an *a la carte* world, because advertising could be targeted at viewers who have been able to express their

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[9] "Comments of the Consumer Federation of America, et. al, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, p. 199.

[10] "The America Channel LLC's Petition to Deny," *In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee,* MB Docket No. 05-192, July 21, 2005 (hereafter TAC Petition), Exhibit 2.

[11] Comments filed in MB Docket No. 04-207, p. 14, cited in TAC Comments, Exhibit 2.

[12] Comments filed in MB Docket No. 04-207, p. 6, cited in TAC, Comments, Exhibit 2.

willingness to pay for programming directly by exercising the choice to subscribe to specific channels. But for now, we do not live in an *a la carte* world. In the linear bundling world dictated by the cable industry practice, massive carriage is necessary to achieve viability.

By creating a marketplace that blunts the force of consumer demand and then allowing cable operators to control the terms of carriage, cable operators become gatekeepers that make or break programming. In this world, rights of carriage, through ownership of cable systems or the holding of must carry/retransmission rights, dictate success. Simply put, it is virtually impossible to succeed in reaching a mass audience without these rights of carriage.

B. DISCRIMINATION IN CARRIAGE IS MORE WIDESPREAD AND PERNICIOUS THAN PREVIOUSLY BELIEVED

The second set of evidence that has come to the fore since the comment cycle in this proceeding closed is GAO's clear finding that cable operators favor their own programming and discriminate against independent programming. In the earlier rounds of comments, the cable industry claimed, based on studies we showed to be flawed and misleading, that there was no discrimination in carriage. In a rigorous econometric analysis, the GAO found that cable operators were 64 percent more likely to carry their own programming.[13] They were 46 percent more likely to carry cable programming developed by broadcast network owners. These are, of course, the two entities that have carriage rights. Given how severely tilted access is against independent programmers, it is hard to imagine how they can possibly succeed.

The GAO findings are consistent with the published econometric analysis that was provided in earlier comments in this proceeding. The findings are quite strong on

[13] U.S. General Accounting Office (U.S. GAO), *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, October 2003; *Telecommunications: Issues in Providing Cable and Satellite Television Service*, October 15, 2003, p. 30.

discrimination. It provides a detailed understanding of foreclosure motivations and behaviors. Integrated owners of basic programming exclude competitors for their basic package but offer more of their own basic packages and more premium packages.[14] Owners of premium services foreclose competitors and sell more of their own programming, but offer fewer services at higher prices.[15]

In fact, the empirical evidence offered by the America Channel shows that the deck is stacked so fully against them that they are virtually doomed to failure (see Exhibit 3). Over 90 percent of the networks that have achieved carriage on systems that pass 70 million or more homes are affiliated with a multiple system operator [MSOs] or a broadcast network. Just under 90 percent of the networks that have achieved carriage on systems that pass 50 million of more homes are affiliated. Affiliated programmers are nine times as likely to gain carriage as independent programmers.

The recent evidence presented to the Commission shows that discrimination at the top of the industry, in terms of the most frequently carried networks, starts at the bottom, in terms of carriage for newly launched networks (see Exhibit 4). Not only are affiliated launches nine times as likely to receive carriage as independent programming, they are also more likely to get better carriage on systems owned by the dominant cable operators – Comcast and Time Warner. The discrimination starts at the beginning and persists through the end, loading the dice against independent programmers.

C. THE D.C. CIRCUIT COURT'S STANDARD FOR ASSESSING THE EFFICACY OF THE HORIZONTAL LIMIT MISREADS THE STATUTE AND IGNORES ECONOMIC REALITY

[14] Chipty, Tanseen, "Vertical Integration, Market Foreclosure, and Consumer Welfare in the Cable Television Industry." *American Economic Review.* Vol. 91, 2002, p. 429.

[15] Chipty, 2000, p. 429.

In light of these two sets of empirical facts, the D.C. Circuit reversal and remand of the 30% limit rests on a narrow theory of foreclosure that undermines the intention of Congress to ensure fair treatment of independent programmers and ignores one of the most important finding of economic analysis of the past half century – the theory of noncollusive games. The Court's standard, which requires the Commission to demonstrate the virtual certainty of collusion in analyzing the impact of two cable operators refusing to grant carriage, fails to recognize that when a small number of firms are present in an industry, parallel actions accomplish virtually all of the anticompetitive harm of collusive activity.

This revolution in economic thinking, which added the concept of the Nash equilibrium to the arsenal of economic analysis, has permeated through a wide range of fields. Beyond collusion,[16] mutual forbearance and reciprocity can occur, as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.[17] The ability of large, dominant firms to look and learn about how others behave and adjust their behavior has been documented across a variety of industries. Even introductory economics texts now contain long discussions of strategic behavior and game theory, and it has become a routine part of applied policy analysis.[18]

This bears directly on the cable industry, since a small number of firms controls access to a large number of TV sets. Indeed, in the cable *a la Carte* proceeding, the fact that programmers only had to market to a handful of cable executives was touted as a huge

[16] Perry, Martin, K., "Vertical Integration: Determinants and Effects." In Richard Schmalensee and Robert D. Willig, eds., Handbook *of Industrial Organization* (New York: North-Holland., 1989), p. 247.

[17] Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), p. 248.

[18] See, for example, Taylor, John B, *Economics* (Boston, Houghton Miflin, 2001) Chapter 11; Hasting, Justine, "Factors that Affect Prices of Refined Petroleum Products" (Washington, D.C. Federal Trade Commission Public Conference, August 2, 2001); Cooper, Mark, "Recognizing Limits of Markets, Rediscovering Public Interest in Utilities," *Natural Gas And Electric Power Industry Analysis*, Robert E. Willett, Ed. (Financial Communications Company, Houston 2003).

transaction cost savings. This small number of executives has make or break power over programming, and they have used that power to favor their own programming at the expense of independent production, exactly the situation Congress intended to prevent.

The real world behavior of the dominant firms in the industry puts an end to any debate over the ability of the dominant firms to determine the fate of independent programmers (see Exhibit 5). Carriage on both Comcast and Time Warner systems is necessary to achieve the level of distribution required to achieve long run success. Not one national network has achieved even half the requisite level of carriage (25 million homes passed) without being carried on both Comcast and Time Warner systems.

Whether or not it is theoretically or mathematically possible to achieve sufficient carriage without cracking the top two is irrelevant. As a practical matter, it simply does not happen if either Comcast or Time Warner denies carriage. There are two real world processes that can account for this, beyond the simple arithmetic.

First, the transaction costs of having to negotiate with a large number of small operators create a severe disadvantage for those denied carriage by the major system owners.

Second, the behavior of the industry leaders sends a strong signal to others – "if Comcast and/or Time Warner decline to permit access to a new independent network, there is strong disincentive for other cable systems, and for competitors, to do so – as they know the survivability of such a network is in doubt."[19] The problem is that the prospects for survival of a new network that is denied access to either Comcast or Time Warner systems is so diminished that "the majority of operators, therefore, are hesitant to dedicate the channel

[19] TAC Comments, p. 27

capacity, marketing and other resources necessary to distribute a product from a programmer whose survivability is uncertain."[20]

This analysis demonstrates that the Commission should continue to use an open field approach and include not just the top firm, but also the top two cable distributors, as it has done in the past. No current programmer denied carriage by either of the top two firms has come close to achieving the necessary reach to attract advertising on the scale that is widely recognized as the threshold for long term survival of national programming. Nor do we believe that the Commission can narrow the intent of Congress by relegating independent programming to niche markets.[21] Based on this new evidence, elaborated below, the Commission must adjust its horizontal limit policy to address the fact that the current industry structure unfairly impedes the flow of independent programming. A dozen years after the Congress first sought a limit, it is time for the Commission to set one that achieves Congress' intent to ensure independent programmers are not unfairly impeded.

[20] TAC Comments, p. 27.
[21] Second Further Notice ¶66,

III. PERSISTENT MARKET POWER IN THE MULTICHANNEL VIDEO PROGRAM DISTRIBUTION MARKET

The Commission asks a series of questions about the impact of the MVPD market structure on the ability of independent programmers to bring their product to market.

In addition to questions about concentration, it inquires about technological changes that have increased capacity. In particular, it cites the claim by AT&T that there are clear public interest benefits to increased cable concentration, mostly as the result of cable operators' economies of scale and the Commission's requirement to take such benefits into account.[22] The Commission notes that others claim "that the cable industry's recent evolution from strictly analog video programming to digital video and non-video offerings has made the industry much more dynamic."[23] The Commission goes on to ask "whether the widespread availability of DBS service, along with its continued strong growth in subscribership since the *2001 Further Notice*, provides an adequate outlet for programming such that diversity is ensured.[24] In assessing how a limit could promote diversity, should we be concerned with maximizing the range of different program types, or maximizing competing sources of each type of programming, or both?"[25]

The Commission claims that none of the comments filed in response to the *2001 Further Notice* yields a sound evidentiary basis for setting horizontal or vertical limits, and is

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[22] AT&T Comments at 69, citing AT&T Comments, Ordover Decl. at ¶129.

[23] PFF Comments at 9, 12-16.

[24] As of June 2004, DirecTV is the second largest MVPD and EchoStar (DISH Network) is the fourth. *Eleventh Annual Report*.

[25] ¶31.

seeking additional comments on an economic foundation for a horizontal limit.[26] CFA and CU disagree.

Initial and Reply comments filed by our organizations in the 2001 Further Notice present empirical evidence to demonstrate how horizontal concentration and vertical integration in the cable industry, overlaid on an industry with substantial barriers to entry, render it vulnerable to abuse of market power.[27] Not only is the industry becoming more concentrated (as measured by the HHI index) but it is also overcharging consumers (as measured by the Lerner index), and capturing massive monopoly profits (as measured by Tobin's q ratios). Each of these measures indicates that the overall competitive situation has become worse since 1992, when Congress charged the Commission with setting a reasonable limit on ownership. The analysis already in the record demonstrating the anti-competitive, anti-consumer, anti-programmer structure, conduct and performance of the industry is updated and elaborated in these comments.

A. LONG TERM PERSPECTIVE

The cable industry was born in the 1970s with franchise monopoly service territories subject to local regulation. The Cable Act of 1984 gave the FCC the authority to deregulate prices in competitive cable TV markets and restricted the ability of local franchise authorities to oversee the industry. Congress had been told that competition between cable companies would grow as new cable operators overbuilt incumbents and competing technologies would add further competition.[28] The FCC determined that three over-the-air channels were enough

[26] Second Further Notice ¶63.
[27] CFA, et al, Initial Comments, Chapters VII, VIII, IX
[28] Subcommittee on Communications, Committee on Commerce, Science and Transportation, Subcommittee, United States Senate. February 16-17, 1983.

to establish effective competition with cable in each community. As a result, cable systems serving about 80 percent of the country were deregulated.

Effective competition failed to materialize either from the entry of additional cable companies into the local franchise area or from other technologies. Over-the-air broadcast signals were extremely feeble competition for cable. Numerous examples of discrimination in programming came to light. Cable prices exploded and public outcry ensued. In the eight years between cable deregulation (1984) and re-regulation (1992), the price of the basic/expanded-basic bundle doubled. Since the passage of the 1996 Act, it has doubled again. Since 1984, the price of the basic/expanded-basic bundle has increased at over five times the rate of inflation.

In an effort to stave off legislation to re-regulate cable, the FCC reconsidered its three over-the-air rule and switched to six over-the-air stations as a standard. However, the pricing abuse was too great, and the FCC's standard too weak to convince Congress that cable's market power would be checked. By 1992, Congress had observed a continuing monopoly at the point of sale, with increasing concentration at the national level and growing vertical integration between programming and distribution. Congress re-regulated cable rates in 1992 and placed a range of "pro-competitive" conditions on the industry, including requirements that the FCC develop a structural limit on ownership (a horizontal limit or cap), rules to ensure access to programming for competing distribution systems, etc.

When Congress revisited the structure of the multichannel video market in the Telecommunications Act of 1996, it decided to relax rate regulation in anticipation of growing transmission competition from satellite and telephone companies. It cautiously left the ban on cross-ownership and the requirement for a horizontal limit in place Congressional caution in the 1996 Act was well grounded, but its optimism about the development of competition for cable was totally inappropriate.

Overbuilding is moribund.[29] One of the great disappointments of the 1996 Telecommunications Act has been the failure of competition from alternative technologies to break down the market power of the incumbents. Congress devoted a whole section of the law to telephone competition for cable through open video systems.[30] Today, open video systems are non-existent.[31] As discussed below, cross-technology competition from satellite is weak as well. This track record teaches us that we should be very skeptical of promises about future technologies that are "just around the corner," which will break the grip of the cable monopoly.

Unfortunately, when Congress decided to move media and communications policy toward greater reliance on competition in the Telecommunications Act of 1996, the cable operators headed in the opposite direction. Rather than use their expertise, existing plant and ownership of programming to enter neighboring service territories, the dominant cable companies chose to buy each other instead. Not one major incumbent has ever sought to overbuild a neighbor to compete against another incumbent. The monopolies they had gained through franchise awards in the 1970s and defended through anticompetitive behavior in the 1980s were merged into ever-larger MSOs and clusters in the 1990s. The result has been a dramatic increase in concentration and clustering of systems. Thus, we should not be

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[29] Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Congress. *Competitive Issues in the Cable Television Industry*. March 17, 1988; Committee on Energy and Commerce, *Report on H.R. 4850*, Senate Committee on Commerce and Science, *Report on S12.*

[30] U.S. C. 47, Title II, part 5.

[31] Federal Communications Commission, 1998, Appendix C.

surprised to find that in the late 1990s, the Assistant U.S. Attorney General for Antitrust called the cable industry "the most persistent monopoly in the American economy."[32]

B. RECENT DEVELOPMENTS AND EVIDENCE

Since that statement was made, mergers have been executed between the first, third and fourth largest companies, creating a single giant that towers over the industry, almost twice as large as the second largest cable operator. Regional markets have been drawn into huge clusters of systems. In a pending merger, the number one and number two cable operators propose to devour the number seven cable company and sharply increase their control over regional markets. Broadcast and cable programmers have merged. Broadcast and satellite distributors have merged.

While cable merges abound, competition between cable systems is almost non-existent. Head-to-head competition between cable companies is virtually non-existent. Out of 3000 plus cable systems, head-to-head competition exists in fewer than 200, although another 150 have certified entry. In short, only about 1 percent of franchise territories have experienced head-to-head competition between cable companies. The failure of competition in multichannel video is most evident in local markets. Although overbuilders target larger urban areas, only one cable company serves about 98 percent of the homes passed in the country.[33] While a number of other communities have authorized additional overbuilding, this

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[32]U.S. Department of Justice, 1998. The Department of Justice press release refers to the "cable monopoly." In remarks made at the press conference, Assistant Attorney General Joel Klein added the adjective persistent.

[33] Federal Communications Commission. "Report on Cable Industry Prices." *In The Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment, 2002*, p. 20.

activity is slowing, as the regional Bell Operating Companies pull back and pure overbuilders retrench.[34] The nation's largest overbuilder recently declared bankruptcy.

Cable's dominance as the multichannel medium is overwhelming, with a subscribership of approximately two-thirds of all TV households. Its penetration is about three times as high as the next multichannel technology, satellite. Because a large number of satellite subscribers live in areas that are not served by cable, competition in geographic markets is less vigorous than the national totals suggest. Cable has about four times the market share of satellite in markets where both are available.

This suggests that cable retains a market share at the point of sale of above 80 percent.[35] The HHI index at the local level is above 6400, at best a duopoly. These market shares and levels of concentration make cable operators virtual monopolies.[36]

This market power at the point of sale is reinforced by a strong trend toward regionalization in which one company gains ownership of many firms in a region (see Exhibit 6). Clustering has increased sharply since 1994, when less than one-third of cable subscribers

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[34] Federal Communications Commission. *In The Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment. Seventh Annual Report,* CS Docket No. 00-132, January 2, 2001, p. 20, notes that cable operators in only 330 communities have been granted status as effectively competitive on the basis of overbuilding.

[35] Federal Communications Commission, 2001, p. 34, notes increasing urban subscribers, but figures show that satellite is still disproportionately rural.

[36] Rosston, Gregory, and Howard Shelanski, "Declaration on Behalf of National Cable and Telecommunications Association." *In The Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 9251, MM Docket No. 87-154. January 3. 2002, p. 23, give a hypothetical local market with a cable firm having an 80 percent market share and satellite having 20 percent in making a point about the impact of concentration in national markets. They never discuss the local HHI, which would be 6800. This meets the antitrust definition of a monopoly.

were in clusters.[37] Just over one-half of all cable subscribers were clustered in 1997, but by 2000 three-quarters were. Today, the figure is over 80 percent[38] and the pending Adelphia-Comcast-Time Warner merger would push it into the 85-90 percent range.[39]

The wave of industry concentration after deregulation is striking at the national level. When cable was deregulated in 1984, the distribution segment was not concentrated at all (HHI about 350), with the equivalent of about 30 equal-sized competitors. A decade later, concentration had advanced to the point where the distribution segment had the equivalent of about 11 equal-sized competitors (HHI about 930), with the market share of the top four firms (CR4) equal to 48 percent of the market. For 2004, the FCC indicates an HHI of just over 1,000 largely because it has expanded its definition to include satellite with a CR4 of 53 percent. However, as we show below, satellite is at best a partial competitor. Concentration calculated for cable only puts the HHI at just under 1,500, with a CR4 of 67 percent.

Econometric evidence confirms what regulators should have known all along, **head-to-head, wireline competition is the only market structure feature that significantly disciplines monopolistic pricing**. In its most recent report, the GAO finds that head-to-head, wireline competition between cable operators lowers prices by 15 percent for basic and expanded basic service (See Exhibit 7).[40] Its earlier report had found a 17 percent difference.[41] FCC econometric models, which identified three types of head-to-head competitors (public, local exchange carriers, and other overbuilders), have consistently found

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[37] Federal Communications Commission, 2002b, Table C-1.

[38] Kagan, Paul Associates. *Major Cable TV System Clusters.* Carmel, California: Paul Kagan Associates 1998; Federal Communications Commission, Tenth *Annual Report.*

[39] If Adelphia is assumed not be clustered, the increase would be over 8 percent. If we calculate only the net increase in large clusters it would be 4 percent.

[40] U.S. GAO, 2003, Appendix IV.

[41] U.S. GAO, 2002.

large price effects from head-to-head, wireline competition.[42] Unfortunately, only about 2 percent of American households enjoy the benefit of head-to-head, wireline competition. The result is an abuse of market power that costs the American public about $4.5 billion per year in cable rates alone.[43]

C. REGIONAL CLUSTERS

The Second Further Notice seeks comment on whether and how the existence of regional markets should affect the development of horizontal and vertical limits.[44] We agree that a regional limit on concentration would better effectuate the statutory purposes set forth in Section 613(f)(2).

In the cable TV industry, market power has been expanded and reinforced by control and distribution of regional programming, especially sports. Regional market power through clustering plays a critical role particularly for advertising markets. Dominating specific programming categories generates both high profits and provides leverage to undermine competitors.

Exhibit 7 also includes the econometric results of market structure characteristics beyond head-to-head competition. It shows that **bigger monopolies are worse when it comes to consumer prices.** In the GAO analysis, if a cable system is part of a large national operator, its prices are 5.4 percent higher than if it is not.[45] The GAO called this horizontal

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[42] Federal Communications Commission, *Report on Cable Prices*, April 4, 2002, Attachment D-1; February 14, 2001, Attachment D-1; June 2000, Attachment D-1; May 7, 1999, C-1.

[43] We assume that 98 percent of cable subscribers lack head-to-head competition (Federal Communications Commission, *In the Matter of the Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming: Ninth Annual Report*, MB Docket No. 02-145, December 31, 2002, para. 115) and 90 percent of those take expanded basic service (ESPN, p. 2). Therefore, 62 million cable households are the victims of abuse of market power. Their bills could be reduced by $8 per month as a result of genuine head-to-head competition and de-concentration of the industry.

[44] Second Further Notice ¶70

[45] U.S. GAO, 2003, Appendix IV.

concentration. Federal Communications Commission (FCC) econometric models have been finding this to be the case for several years, with even larger effects of being part of a multiple system operator (MSO).[46] When the FCC models add in a specific variable for regional clustering, a dramatic trend in the industry, they find that clustering has an added effect of further raising price.[47] Consumers served by one of the mega-MSOs, who have been expanding their grip on the industry through mergers and clustering, suffer higher prices by more than 5 percent and perhaps as much as 8 percent. Thus, there could be as much as an additional $1.5 billion in consumer savings that could be wrung out of the cable market if it were de-concentrated.

The important implication is that the theory used to allow large cable operators to become larger is not supported by the empirical evidence. That theory claimed that the combination of larger, clustered systems would create efficiency-based cost savings that would be passed on to the public because one big monopolist is no worse that two, contiguous smaller ones. Since large incumbents never overbuild one-another and compete, the claim is that there was little to be lost. The econometric evidence suggests that there is, in fact, considerable harm. It turns out that large operators and clustered systems have more muscle to thwart competition and impose price increases. They can distribute programming terrestrially and extract exclusivity deals from independent programmers, thereby denying programming to competing distribution media (overbuilders and satellite). They have more

[46] FCC, *Report on Cable Prices*, April 4, 2002, Attachment D-1; February 14, 2001, Attachment D-1; June 2000, Attachment D-1; May 7, 1999, C-1.

[47] FCC, *Report on Cable Prices*, February 14, 2001, Attachment D-1; June 2000, Attachment D-1.

leverage over local governments to obstruct the entry of overbuilders. If they knew they could not grow through mergers, they might compete by overbuilding one another.[48]

D. PRICE INCREASES AND PROFITS ARE SKYROCKETING

With the efficiency explanation thoroughly discredited by empirical analysis at every point, the Commission must look elsewhere to explain the pattern in the data. The explanation that fits is that market power is being exercised by cable operators at the point of sale.

For the consumer, the final word on market power is the cost of cable service they have to pay on a monthly basis; for the industry, the final word of market power is the bottom line (see Exhibit 8). Since the passage of the Telecommunications Act of 1996, monthly rates for basic and expanded basic cable have doubled. Over that same period, the cash flow per year, per subscriber has almost doubled as well, increasing by about 90 percent. As the FCC notes in its most recent annual report, "cash flow (generally expressed as earnings before interest, taxes, depreciation and amortization or EBDITA) is often used to assess the financial position of cable firms and other companies in capital intensive industries."[49]

The fact that the bulk of the basic rate increase has been taken out as operating cash flow means that cable rate increases have been much larger than operating expenses (see Exhibit 9). In particular, the claim that rising programming costs have caused basic rate increases is false. Increases in revenues have far outstripped increases in programming costs. In fact, non-programming expenses, largely associated with high-speed Internet and digital cable offerings, have increased much faster than programming expenses. Nevertheless, even these increases have not been sufficient to hold down the tremendous rise in cash flow.

[48] Cooper, 2002, Chapter 7.
[49] *11th Annual Report*, p. 19.

Traditional video revenues, including monthly charges for basic and expanded-basic rates and local advertising revenues, have increased by over $100 per subscriber per year, which is equal to about two-thirds of the total increase in cash flow (see Exhibit 10). To add an exclamation point, Comcast reported a 64 percent increase in its profits for the first half of 2005. The trend appears to be continuing.

IV. BUNDLING

In the Second Further Notice, the Commission seeks comments on how changes in the MVPD industry in the past several years impact the current debate.[50] Citing increased plant capacity and upgraded systems, the Commission asks for comment on the impact of digital tiers on carriage for independent networks,[51] and the effect that video on demand (VOD/SVOD) may have on the opportunity for independent programmers to gain distribution of their programming.[52]

A. Denial of Choice in the Purchase of Programming

Cable offers consumers a narrow set of choices of bundled and tied channels and services (see Exhibit 11). That is, cable bundles programming into tiers, forcing consumers to purchase all the programming in the tier, if they want any of it. Cable then ties tiers together, forcing consumers to buy lower tiers, if they want to purchase upper tiers.

Households must buy basic service, with about 16 channels at a cost of about $18 per month (including equipment costs) to receive any video service. Once basic is purchased, the most popular cable programming is bundled into the "expanded basic" (or cable programming) service tier, which contains over 50 channels, at an average cost of about $27 per month. In order to access the digital tier service (including VOD), the consumer must purchase expanded basic.

Digital is not an option for consumers who do not want to pay for large packages of service. The consumer must buy expanded basic if he or she wants digital service. The digital service is also a large bundle, consisting of 30 channels, which are offered on a take-it-

[50] Second Further Notice ¶49
[51] Second Further Notice ¶54
[52] Second Further Notice ¶55

or-leave-it basis. It now costs more than basic service (when equipment costs are included). Digital tier service is then tied to video on demand. The consumer must buy the digital tier in order to purchase video on demand.

In essence, cable operators force consumers to buy about 100 channels in three, large, all or nothing bites, at a total cost of over $60 per month before they even get to the point where content could bypass a program network (VOD).

In some cases cable operators have begun to offer programmers the opportunity to prove themselves on a stand-alone basis in the video-on-demand space, but this provides little real opportunity. In other words, **after the cable operators have collected about $60 per month from subscribers and chosen about 100 channels, independent programmers are offered the opportunity to compete for the scraps of discretionary income and viewer attention that might be left.**

Therefore, while increased channel capacity and video on demand could, in theory, provide the opportunity for independent distribution of programming, bundling works against realization of that potential. Bundling enables the cable operator to tightly control the flow of programming, despite the flexibility that the term "video on demand" may imply.

For that reason, we have recommended mixed bundling – the offer to select either channel packages and/or channels on a stand-alone basis. Under these circumstances, if consumers were offered the opportunity to choose between bundles and an *a la carte* menu of the same programs, it is likely that the total rate paid by consumers for the programs they would choose to purchase would be reduced and consumer satisfaction would increase. One of the many benefits of the mixed regime is that it would diminish the power of cable operators to control who has access to the public by increasing the opportunity for independent programs to rise or fall on their merits, rather than on whether they conform to the interests of the cable operators. Absent mixed bundling, digital tiers and VOD do not really increase the opportunities for distribution of independent programming on cable systems because the vertically integrated MSOs continue to act as gatekeepers, controlling access to the tiers for both viewers and programmers.

B. THE ANTI-CONSUMER, ANTI-COMPETITIVE POTENTIAL IN CABLE BUNDLING

As demonstrated in our comments filed in previous proceedings,[53] the industry practice of "bundling" is anti-competitive and has increased overall cable prices to consumers and limits access to digital tiers and VOD.

Over the past two decades, the anticompetitive potential of bundling has been explored and documented in detail. Indeed, almost immediately after the Chicago school of economic analysis tried to conclude that all bundling be deemed, *per se*, benign,[54] the potentially anticompetitive effects of bundling reemerged in the literature. This literature concluded that bundling engenders market efficiency only when the market is characterized by extreme conditions (i.e., permanent monopoly in one product, perfect competition in the other). In the more common situations, firms whose market power is neither total, nor permanent, can use bundling to defend or extend their market power, leading to further inefficiencies in the market. Under a wide range of assumptions, the dynamic[55] ability of bundling to undermine competition has been demonstrated through a number of mechanisms including inducing

[53] CFA/CU, a *la Carte,* Initial Comments.

[54] Richard Posner *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 1976), Robert Bork, (*The Antitrust Paradox: A Policy At War With Itself,* (New York: Basic Books, 1978).

[55] J. Kaplow, "Extension of Monopoly Through Bundling," *Columbia Law Review,* 85:1985; J. A. Sykes, Ordover, A. Sykes and R.D. Willig, "Nonprice Anticompetitive Behavior by Dominant Firms Toward the Producers of Complementary Products," in F.M. Fisher, ed., *Antitrust and Regulation: Essays in Memory of John J. McGowen* (Cambridge, MA, The MIT Press, 1985).

exit,[56] creating barriers to entry,[57] relaxing price competition,[58] distorting investment,[59] retarding innovation,[60] and extending market power into new markets.[61]

These concerns about the anticompetitive effects of bundling are especially relevant to the goals of public policy as expressed in the Telecommunications Act of 1996, which defined "diversity" not by the variety of programs available, but by the number of independent producers.[62] The ability of dominant firms to add programs to bundles and exclude independent firms may increase variety, but it does not contribute to diversity. Simply put, the current system lacks diversity. The Center for Creative Voices in the Media's filing makes this point nicely:

> The so-called '500 Channel Universe' provides no relief from this concentration and lack of diversity of viewpoints and voices. Evidence in the Biennial record shows that of the 91 major cable television networks each available in more than 16 million homes, fully 80 percent (73 networks) are outlets owned or co-owned by the same five media giant conglomerates that control a 75% share of the national audience, plus Liberty Media. ... Using the principles the Commission laid down in the 2002

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[56] M. Whinston, "Tying Foreclosure and Exclusion," *American Economic Review,* 80: 1990.

[57] O.E. Williamson, "Assessing Vertical Market Restriction: Antitrust Ramifications of the Transaction Cost Approach," *University of Pennsylvania Law Review,* 127:1979; B. Nalebuff, "Bundling as an Entry Barrier," *Quarterly Journal of Economics,* 2004, "Bundling," Manuscript, School of Management, Yale University, 1999; Y. Bakos and Eric Brynjolfsson, "Bundling and Competition on the Internet: Aggregation Strategies for Information Goods," *Marketing Science,* 19:2000.

[58] J. Carbajo, D. de Meza and D. Seidman, "A Strategic Motivation for Commodity Bundling," *Journal of Industrial Economics,* 38: 1990; Y. Chen, "Equilibrium Product Bundling," *Journal of Business,* 70: 1997.

[59] J. P. Choi and C. Stefanadis, "Tying, Investment, and the Dynamic Leverage Theory," *Rand Journal of Economics*, 32:2001.

[60] J. P. Choi, "Tying and Innovation: A Dynamic Analysis of Tying Arrangements," *The Economic Journal* 114: 2004; J. P. Choi, "Preemptive R&D, Rent Dissipation, and the 'Leverage Theory'," *Quarterly Journal of Economics,* 110:1996.

[61] D. W. Carlton, "The Strategic Use of Tying to preserve and Create Market Power in Evolving Industries," *Rand Journal of Economics,* 33:2002;

[62] This definition makes intuitive sense. As stated in the comments of the Center for Creative Voices in the Media (CCVM) comments in the *a la Carte* proceeding, pp. 4-5, "few would suggest that Chevrolet and Cadillac are separate automotive company 'viewpoints.' Rather, the 'viewpoint' is that of their conglomerate owner, General Motors. The same principle holds true in television with regard to conglomerates that own multiple distribution outlets positioned to appeal to different segments of the viewing audience, just as Chevrolet and Cadillac are positioned by GM to appeal to different segments of the car market. The 'viewpoint' is that of the owner – the conglomerate – and not of its subsidiary distribution outlet."

> Biennial, the inescapable conclusion is that television today is excessively concentrated and viewpoint diversity is inadequate.[63]

The best that can be said of the current no-alternative bundles imposed on consumers is that, in a static analysis, they may expand total social surplus while reducing consumer surplus.[64] In other words, producer surplus may increase more than consumer surplus declines, increasing total surplus. Even the conclusion to this static analysis is dubious, as it is unclear whether producer surplus has increased more than consumer surplus has fallen.

Under a dynamic analysis, the enrichment of producers is not random. The current system favors a small number of dominant producers and creates barriers to entry for small, independent outlets, resulting in little diversity in ownership. Leveraging their market power through forced bundling, the large operators and dominant programmers not only reduce diversity, but also diminish competition, leading to inefficiencies in the market. Because bundling reduces competitive pressures, the total surplus is limited. When reality is injected into the theory, the cable industry argument falls apart even faster. There is no reason to believe that prices will skyrocket in an environment where consumers are allowed to choose between bundles and individual programs. In a more competitive, consumer-friendly environment, total surplus might well be higher.

Defenders of bundling dismiss the existence of (and, in some cases, the possible existence of) this type of anticompetitive behavior. As the Comcast-funded economist puts:

> Under a leverage motivation, a supplier uses it[s] market power with respect to one product to gain an advantage in the sale of a second product by tying sales of the two together. Leverage can take the form of driving rivals out or

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[63] Center for Creative Voices in the Media, a *la Carte,* pp. 6 and 8.

[64] This observation has been well established in the economics literature for two decades. Recent works extends it to information goods in theory (Yannis Bakos and Erik Brynolfsoson, “Bundling Information Goods: Pricing Profits and Efficiency,” *Management Science*, December 1999, p. 1) and cable in reality (Gregory S. Crawford, *The Discriminatory Incentives to Bundle in the Cable Television Industry,* April 2, 2004, p. 20).

excluding entrants.

> The leverage theory clearly is irrelevant to the analysis of bundling cable programming: there is no evidence that tiers have been created to make entry by new networks or new operators more difficult. In fact, tiers have the opposite effect.[65]

This statement is contrary to empirical reality.[66] When large cable operators carry networks in which they have an ownership interest, but refuse to carry competing networks from unaffiliated programmers, they distort the marketplace. When dominant national programmers tie niche and emerging networks to their popular programming during retransmission negotiations, they leverage their market power to gain an advantage over independent, competing programming.

The record is rife with solid evidence from smaller and independent MVPD operators, independent content producers, local cable commissions and independent programmers that discrimination takes place with the largest programmers bundling to force cable operators and consumers to take networks that would not be taken in the absence of leverage.[67]

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[65] Katz, Michael, *Slicing and Dicing: A Realistic Examination of Regulating Cable Programming Tier Structures*, July 15, 2004, p. 26.

[66] Declaration of Robert Willig, Orszag and Ezrielev, *Regarding A La Carte Pricing*, July 15, 2004,provide a perfect example of the blind spot in the industry-funded analyses. They cite the dispute between YES and cablevision as testimony to the fact that profits are higher through widespread distribution, but ignore the fact that Cablevision was attempting to leverage it control over distribution to force YES onto a separate tier, while its own, vertically integrated competing sports programming, remained on the expanded basic tier. Our initial comments examined the YES lawsuit and dispute with Cablevision as solid evidence of discrimination and leverage, which these analysts have ignored entirely.

[67] Numerous examples may be found in the initial comments filed in this proceeding. For example, CCVM (page 9) quotes an Echostar press release: "Among Viacom's strong-arm tactics is the demand that the DISH Network carry Viacom-owned channels of little or no measurable appeal to viewers in exchange for the rights to carry the 16 owned-and-operated CBS stations. Viacom also threatened to withhold the Super Bowl from the DISH Network customers until a federal judge intervened." According to the Pioneer Telephone Association's filing (page 6), "Many broadcast networks have begun to demand regular monthly licensing fees for access to 'free' over-the-air broadcast signals. … One local broadcast network affiliate even went so far as to demand that our small cable system would have to agree to purchase a fixed and substantial amount of advertising on the broadcaster's station, in exchange for consent to retransmit their broadcast system. The American Cable Association's filing states (on page 30) "ACA has described the smaller cable sector's increasing concern about the use of retransmission consents by network owners and affiliate groups. The principal tactic – requiring carriage of affiliated satellite programming as a condition of access to local broadcast

C. New Delivery Systems Are Immature and Cannot Discipline Cable Market Power over Consumers and Programmers

Although in many respects the Internet gives consumers access to multiple independent sources of content, the Internet is far from a viable option as a distribution channel for independent video programmers to reach consumers.[68] First, far fewer consumers have access to the necessary high-speed broadband connection than have access to cable. The number of high-speed Internet service subscribers is somewhat above 35 million,[69] while the number of MVPD subscribers is in excess of 90 million.[70]

Because the FCC has adopted an extremely low threshold for classifying a service as high speed, these numbers are misleading. The number of advanced service high-speed Internet subscribers, subscribers whose service is more likely to be a candidate to support video is much smaller – in the range of 25 million. Cable accounts for well over 80 percent of those lines.[71] Cable is not going to allow its lines to be used to undermine its video franchise and imposes conditions on consumers that prevent this.[72] Cable also ties basic service to many of its cable modem services, by discounting 25 percent for consumers who take both

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signals. As a result, smaller cable companies and their customers must pay for programming that they would not otherwise choose, solely to receive a free, over-the-air local broadcast station." Echostar's comments (page 1) states "MVPD's flexibility to offer a la carte and tiered services is inhibited today by many factors. First and foremost among them is the practice of large media conglomerates of bundling their must-have programming, including in particular the local network broadcast stations and the most popular cable networks, with programming that consumers do not want. Faced with widespread bundling, MVPDs currently have little choice but to offer broad *packages* [to consumers]." This is just a small sample of the myriad examples in the initial comments filed; this is not a competitive market.

[68] Second Further Notice, ¶56

[69] Schatz, Amy, "FCC May Set Rules Allowing Bells Exclusive Access Over DSL Lines," *Wall street Journal,* August 5, 2005, shows 32.5 million, based on FCC numbers, for December 2004. The first half of 2005 has increased the total.

[70] Eleventh Annual Report, p. 22;

[71] National Cable & Telecommunications Association, *2005 Mid-Year Industry Overview,* p. 10.

[72] Wu, Tim, "Network Neutrality, Broadband Discrimination," in Mark Cooper (Ed.), *Open Architecture as Communications Policy* (Center for Internet and Society, Stanford, 2004).

Internet and basic cable.[73] In short, the on-the-ground capacity to do video over high-speed Internet service without cable is limited.

Second, Internet based services are “not ready for prime time.” Currently, video over the Internet is primarily in the form of streaming video. As the MVPD report concludes: “Most instances of video streamed over the web, however, are still not of broadcast quality, and the medium is still not seen as a direct competitor to transition video services.”[74] IPTV, or video using Internet Protocol, is even more in its infancy. Despite a recent spate of announcements by Regional Bell Operating Companies who plan to offer IPTV, the service is still years away.[75] Significantly, IPTV video will not be available to all consumers, whether they want an alternative to cable or not. For example, SBC has proposed to extend IPTV to 18 million of its “high value” households by the end of 2007, a fraction of its total subscribers.

This is the umpteenth time since deregulation in 1984 that we have heard the claim that a new technology is about to break the stranglehold of the cable operators on the MVPD market. While there is more competition today in some markets for some customers, the market power of the cable operators has not been rooted out by any stretch of the imagination, particularly for independent programmers.

[73] Cooper, Mark, “Anticompetitive Problems of Closed Communications Facilities,” in Mark Cooper (Ed.), *Open Architecture as Communications Policy* (Center for Internet and Society, Stanford, 2004).

[74] Eleventh Annual Report, p. 8

[75] Cleland, Scott, *SBC’s Video Story Doesn’t Add Up: Behind the Project Lightspeed Façade*, Precursor, July 22, 2005.

V. VERTICAL INTEGRATION AND MUST CARRY RIGHTS

The Commission asks a series of questions relating to the success of unaffiliated programming networks.[76] As we outlined in our *A la Carte* comments, there are a number of factors that prevent new programming networks that are not affiliated with any cable operator or broadcast network from becoming successful.

A. THE SOURCE OF CONCERN

The underlying rationale for a horizontal limit on ownership is to prevent the abuse of vertical leverage over programming. Our comments on vertical integration examine the practices that cable operators use to control the flow of programming that reaches the public. With the exception of the in-house programmers who are owned in whole or in part by cable operators and large broadcast networks, whose must carry/retransmission rights give them guaranteed access to carriage, cable channels are faced with a simple take it or leave it proposition. They must acquiesce to the cable operator's demands in order to gain carriage in the expanded bundle, or starve. We have already noted the econometric evidence that shows carriage rights are leveraged by cable operators and broadcasters to gain an unfair advantage over independent programmers in placing their content before the public. This section looks at the practical outcome of those discriminatory carriage practices.

Vertical issues must also be a factor in this proceeding because cable operators have substantially integrated into programming. In economics, vertical integration is a potential concern, especially when dominant firms become integrated across markets for critical inputs. CFA, et al, Initial Comments in the 2001 Further Notice describe in detail the economic

[76] Second Further Notice, ¶¶59-60

theory behind limits on vertical integration.[77] The anticompetitive conduct and negative market performance result from weakened markets due to vertical concentration.

While the Eleventh Annual Report found a decrease in the percentage of vertically-owned networks,[78] the Report also shows that vertically integrated networks continue to have the largest number of subscribers[79] and are the most popular.[80]

Vertical integration can create barriers to entry. By integrating across stages of production, incumbents may force potential competitors to enter at both stages, making competition much less likely.[81] Vertical mergers can also foreclose input or output markets to competitors.[82] Exclusive and preferential deals for the use of facilities and products compound the problem.[83] Cross-subsidization is more readily accomplished.[84] Vertical integration facilitates price squeezes and enhances price discrimination.[85]

Concerns arise that not only will the dominant firm in the industry gain leverage across input and output markets to profitably engage in anti-competitive conduct,[86] but also the dynamic processes in the industry will clearly shift toward cooperation and coordination

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[77] CFA, et al, Initial Comments, pp. 84-89

[78] Eleventh Annual Report ¶145

[79] Eleventh Annual Report ¶150

[80] Eleventh Annual Report ¶151

[81]Perry, 1989, p. 247. "[V]ertical mergers may enhance barriers to entry into the primary industry if entrants must operate at both stages in order to be competitive with existing firms and if entry at both stages is substantially more difficult than entry at one stage." Scherer and Ross, F. M., and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company: Boston, 1990), pp. 526-527.

[82] ; Shepherd, William G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), pp. 289-290.

[83] Perry, 1989, p. 247; Shepherd, 1985, p. 294.

[84] Asch, Peter, and Rosalind Senaca, *Government and the Marketplace* (Chicago: Dryden Press. 1895), p. 248; Shepherd, 1985, p. 302.

[85] Scherer and Ross, 1990, p. 524.

[86] There is a growing body of theoretical and empirical analysis that has reinvigorated concerns about the anti-competitive impacts of vertical integration, particularly in the cable industry, see Krattenmaker, T.G., and S. C. Salop, 1986 "Anti-competitive Exclusion: Raising Rivals' Costs to Achieve Power Over Prices," *The Yale Law Journal*, Vol. 92; Ordover, Janusz, A. Oliver Sykes, and Robert D. Willig, "Non-price Anti-Competitive Behavior by Dominant Firms Toward the Producers of Complementary Products," In F. M. Fisher, ed, *Antitrust and Regulation* (Cambridge: MIT Press: 1985).

rather than competition. Mutual forbearance and reciprocity can occur as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.[87] The final behavioral effect is to trigger a rush to integrate and concentrate. Being a small independent firm at any stage renders a company extremely vulnerable to a variety of attacks.[88]

The vertical problem is readily identifiable in the market for video programming. A small number of firms that control distribution are integrated into the production of programming. As a smaller number of owners control a larger share of the market, they gain greater and greater leverage in the bargaining with independent producers. Indeed, they can make or break programming.

It is also important to recognize that complete foreclosure is not the only concern. The terms and conditions of carriage are at least as important. Vertically integrated firms defend the marquee programming in which they have a direct interest by frustrating entry and extracting rents from others.

> The power to foreclose also implies the ability to force down the license fees that an MSO pays to networks. Some anecdotal evidence suggests the possibility that larger MSOs hold significant monopsony power in the programming market.[89]
>
> Carriage data provide an incomplete picture of vertical integration's effects on premium networks. In particular, even if both affiliated and unaffiliated networks are carried, an integrated system might price them differently to subscribers. Personal selling and other marketing tactics offer other opportunities for system operators to favor one available network over another… For the most part, those subscribership results suggest that integrated systems also tend to favor their affiliated premium networks in

[87] Asch and Senaca, 1985, p. 248.
[88] Scherer and Ross, 1990, pp. 526-527; Shepherd, 1985, p. 290.
[89] Waterman, David, and Andrew A. Weiss, *Vertical Integration in Cable Television*. Washington, D.C.: AEI Press. 1997, p. 66.

pricing and promotion behavior.[90]

By forcing consumers to take large bundles and controlling the content of the bundles, cable operators control the flow of content and the access of programmers to the public. By leveraging their control of distribution, they ensure favorable treatment for their own shows.

B. THE CABLE FAIRY TALE: THE DANCE OF THE ENLIGHTENED ELEPHANTS

The cable industry and its experts argue that discrimination and anticompetitive conduct by cable operators as buyers in the programming market simply cannot and does not happen.[91] However, two decades of evidence from the deregulated cable industry, demonstrates that "It does happen on a regular basis."

Cable experts argue that monopsony power does not matter in the cable TV industry because of the nature of the product — i.e., video programming is a highly differentiated product with high first copy costs.[92] If products are very different from each other, the cable experts argue, they possess attributes that distinguish them in the mind of the consumer, which enables the programmers who own popular content to withhold their products and force

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[90] Waterman and Weiss, 1997, pp. 93…94.

[91] Ordover, Janusz, A. 2002b. "Declaration" attached to "Application and Public Interest Statement," *In The Matter of Applications for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corp., Transferors, To AT&T Comcast Corporation, Transferee*, February 28, 2002 (Ordover 2002b); Ordover, Janusz A., "Declaration on Behalf of AT&T," attached to "Reply to Comments and Petitions to Deny Applications for Consent to Transfer" *In The Matter of Application for Consent to the Transfer of Control of Licenses Comcast Corporation and AT&T Corporation, Transferors, to AT&T Comcast Corporation, Transferee*, MB Docket NO. 02-70, May 21. Joskow Paul, and Linda McLaughlin, "An Economic Analysis of Subscriber Limits," attached to Comments of AOL Time Warner *In The Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154. January 3., 2002c; Rosston and Shelanski, 2002.

[92] Ordover, 2002c, para. 13, 26.

multiple system operators (MSOs) to enter fair and efficient deals.[93] Even where the cable operators might have market power, the cable experts claim, cable operators realize that they share a strong interest with programmers to ensure the flow of quality programming, so they treat programmers fairly.

In order to make this analysis plausible, cable industry experts must assume away key facts about the cable market. The resulting picture they paint bears no relationship to reality. They assume no ability to price discriminate,[94] no market power for the buyers,[95] a lack of specialized inputs,[96] fair competition for the sellers[97] and highly differentiated products.[98] With the most challenging problems assumed away, the cable company experts have reduced the entire analysis to a battle over rents between cable operators and major programmers, which they assume can have no basis in public policy.[99] But in this proceeding it is the independent programmers who are the victims that Congress intended for the Commission to protect from unfair treatment.

In order to put a reasonable face on the "bargaining" that results, the cable experts must assume what is essentially a marketplace of huge and powerful programmers, some of whom are vertically integrated, facing off against huge and powerful MSOs, some of whom are integrated.[100] In addition to being vertically integrated, other strategies that might help

[93] Ordover, 2002a, p. 36; 2002c, para. 15, 35, 36.
[94] Ordover, 2002a, p. 34; 2002c, para 29.
[95] Ordover, 2002a, p. 37.
[96] Joskow and McLaughlin, 2002, p. 9.
[97] Ordover, 2002a, p. 35; Ordover, 2002c, para. 30.
[98] Ordover, 2002c, para. 15; Joskow and McLaughlin, 2002, p. 10.
[99] Ordover, 2002a, pp. 17, p. 36; 2002c, para. 43.
[100] Ordover, 2002c, para. 87.

programmers survive are to have large portfolios of programs[101] or to sell in foreign markets.[102]

The most dramatic demonstration of the gatekeeping function of carriage can be found in the claim that MSOs ask programmers for an equity stake in their channels or desire exclusive arrangements to lower the programmer's risks or increase profits. Equity is not the problem that programmers must overcome, however. The stumbling block for programmers is not raising capital or assembling talent to create programming. The only thing they lack is carriage. Programmers do not ask MSOs to take equity stakes or seek benefits in deals that prevent them from making their shows available to all means of distribution; MSOs extort equity or exclusive arrangements from programmers by withholding carriage. The MSOs control the programming market and undermine competing distribution systems with their anticompetitive and discriminatory practices.

The dance of the elephants tramples the mice (independent producers) and the grass (consumers). There is little room for independent, modestly sized, domestic producers of programming in this dance. Therefore, in the hypothetical cable world, small independent entities depend on the enlightened self-interest of the cable operators to protect them. They need not fear in this fantasy world because cable operators behave well. Indeed, the bigger the cable operator, we are told, the better they treat the small independent producers because they have too much to lose.[103] The facts show that this is not the case. The larger operators, who own their own programming, favor themselves at the expense of independents.

[101] Ordover, 2002a, pp. 16, 21; 2002c, paras. 11, 74.
[102] Ordover, 2002a, pp. 29-30; 2002c, paras. 74-75.
[103] Ordover, 2002a, p. 40; 2002c, para. 35; Joskow and McLaughlin, 2002, p. 15.

C. The Practical Effects of Discrimination in Carriage Unfairly Impedes Independent Programmers

1. Affiliated Entities Dominate National Networks

Do the assumptions underlying the theory properly reflect economic reality? In the case of the cable commenters, the answer is no. Cable operators discriminate and use other anticompetitive practices by leveraging their control of distribution to defend their franchise product. Evidence of these problems is both qualitative and quantitative and it comes from both integrated and nonintegrated entities.[104]

No matter from what angle we view the audience, we find that a handful of entities dominate. Looking at the most popular programming, which accounts for the vast majority of cable viewing, we find that seven entities dominate (see Exhibit 12). Defining the most popular programming based on a long term series compiled by the FCC of top 20 networks in terms of subscribers and the top 15 in terms of prime time ratings, we find that seven entities completely dominate. Six of these have dominated throughout the past decade. Three were networks (ABC, CBS and NBC). Two are cable operators (Time Warner and Comcast). While Comcast had not been heavily involved in national programming, focusing instead on regional news and sports, with its recent acquisitions of large cable operators, it is now moving aggressively to expand its ownership and control of programming. One of the dominant firms (Liberty) has been spun off and pulled back various times in cable and broadcast transactions. As a result, it maintains a variety of close relationships with cable operators through carriage deals and stock ownership and with networks through stock ownership. The seventh member of the club, Fox, which has recently entered this tight circle,

[104] Ahn, Hoekyun, and Barry R. Litman, "Vertical Integration and Consumer Welfare in the Cable Industry." *Journal of Broadcasting and Electronic Media.* Vol. 41. 1997.

is a broadcaster and now an owner of the largest DBS company. Liberty owns a substantial share of stock in News Corp., the parent of Fox.

The pattern of development of programs shows a cable operator controls the most popular programming. As described in the Eleventh Annual Report, vertically integrated programming tends to attract the largest number of subscribers and achieves the highest ratings.[105] These channels account for over one-half of cable's primetime viewers and about one-third of cable's all-day viewers. Of the top 20 non-broadcast video programming networks, 7 are vertically integrated with a cable operator and 12 are affiliated with another media company that is also affiliated with a broadcast network. The last of the top 20 networks, CSPAN, is funded by MVPDs.[106] In other words, programmers must either own a wire or have transmission rights to be in the top tier of program networks.

One of the keys to proper analysis of discrimination is to pay careful attention to the actual reason for discrimination – i.e. the analyst must differentiate between programs within specific categories. Different categories of programming – such as news versus entertainment – are clearly differentiated. There is also an effort to create differentiation within program categories through branding. Hit comedies are distinct and the producers of such programs may have bargaining power. At the same time, there is a process of rivalrous imitation in the industry.[107] One of the ways these entities dominate the dial is to parlay control over marquee

[105] Eleventh Annual Report, ¶150-151

[106] Eleventh Annual Report, ¶150 and Appendix C-6

[107] Dimmick, John, and Daniel G. McDonald, "Network Radio Oligopoly, 1926-1956: Rivalrous Imitation and Program Diversity." *Journal of Media Economics*. . Vol. 14. 2001, p. 201.

> [R]ivalry in the broadcast network television industry have been clearly mapped… patterns of imitation that might be described as rivalrous imitation among the television networks. Program types that were popular, as indexed by ratings, were more likely to be imitated, while less popular program types were not. Imitation takes the form of emulating programs with high ratings and also spin-offs of successful series. As evidenced by other studies, the result of such rivalrous imitation among television networks was a decline in program diversity.

programming in one category into a suite of offerings across different categories (see Exhibit 13). The categories used are those that were developed in the Booz Allen Hamilton study commissioned by the NCTA for the *a la Carte* proceeding. The program suites fill the dial. That Comcast is moving aggressively to fill out its suite is also notable.

Six entities completely dominate the programming landscape, accounting for three-quarters of the channels that dominate prime time, programming expenditures and writing budgets of the video industry (See Exhibit 14). They completely dominate the basic and expanded basic tiers. They also dominate the realm of networks that have achieved substantial carriage. These 6 entities account for almost 80 percent of the 90+ networks with carriage above the 20 million mark. They account for 80 percent of all carriage in that category. Comcast's national programming would push this total to well over 80 percent for both the number of networks and the share of total carriage.

GAO analyzed roughly the same universe of networks. It found that cable operators are majority owners of one-fifth of the top 90 national networks. A one-fifth share of the most popular programs is a very substantial stake in the programming market, and it blunts cable operators' incentive to resist price increases. Cable operators own minority stakes in other networks, as well. Although the GAO report concludes that 38 percent of the cable networks are majority owned by non-cable, non-broadcast firms, a much smaller percentage, less than 20 percent, do not have at least *some* minority ownership of broadcasters or cable operators. With their market power at the point-of-sale, cable operators know that they can pass costs through to consumers and they can assure that their own programs are carried much more frequently than those of others, thereby gaining a disproportionate share of the overall increase in programming costs.

2. Newly Launched Affiliates Receive Favorable Treatment

The cable industry's data underscore the problem faced by new entrants (see Exhibit 15). Of the 39 new networks created between 1992 and 2002, only 6 do not involve ownership by a cable operator or a national TV broadcaster. Eighteen of these cable networks have ownership by the top four cable MSOs. TV broadcasters are involved in 15. These numbers show there has been little change in the programming environment.

Further, a detailed analysis offered by the cable industry identified eleven networks that have achieved substantial success since the passage of the 1992 Act. Every one of these is affiliated with an entity that has guaranteed carriage. Five of these are also associated with a strategy of launching by using scraps from the cutting room floor/or as a spin-off of a sister channel. In the case of the spin-offs, they use the name of the successful show and focus on a subcategory of issues or ideas originally covered by the hit show (CNN begets CNN Headline News and CNNFI). In the case of cutting room floor shows (particularly news), they use content created but not used by the hit show, in addition to simply reusing content that was already used. Viewers receive a ten-second sound byte on the broadcast news and a three-minute interview on the cable news. There are three networks on this list with fewer than twenty million subscribers, two associated with broadcasters and one with an MSO. Three have disappeared, having been acquired by dominant programmers in the same category.[108]

3. Regional and Niche Markets

The Second Further Notice seeks comment on whether and how the existence of regional markets should affect the development of horizontal and vertical limits[109] and "on the role of niche networks in the development of genre-specific programs that may target

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[108] Moss, Linda, "DCI Buys Some Health." *Multichannel News*, September 3, 2001.
[109] Second Further Notice ¶70

audiences that are too small and specific to make them attractive to general entertainment networks or networks serving other genres."[110] While certain regional sports properties may provide an anticompetitive lever against competing distribution systems if they are distributed terrestrially, these two genres do not provide a solution to the problem of unfair treatment of independent programmers.

The FCC identifies fewer than 100 regional cable networks. Sports and news networks dominate the total, with about 40 percent each (see Exhibit 16). Cable operators are the most frequent owners of these networks, accounting for 44 percent. Broadcast networks account for just over 30 percent of the total regional networks. In other words, three quarters of the regional networks are dominated by the same entities that dominate national programming.

The size of the niche/regional market is extremely small compared to the national market (see Exhibit 17). Based on 2002 data, we identified 124 niche and regional networks with fewer than 20 million subscribers. Four of these have moved past 20 million (all four were affiliated). The total market of these networks is less than one-tenth the size of the national networks with 20 million or more subscribers. Moreover, affiliated networks account for just over half of all networks even in the niche/regional categories and over 70 percent of all subscribers. Even if niche/regional program is considered an outlet that mitigates the severe discrimination in the national market, the market is too small and the discrimination is still quite strong there. There is little relief for independent programmers here.

D. QUALITATIVE EVIDENCE ON ABUSE OF GATEKEEPING POWER

[110] Second Further Notice ¶66

Occasionally, practices within the industry became so bad that collegiality breaks down and even major players became involved in formal protests. Viacom and its affiliates, a group not interconnected significantly with the top two cable operators in the industry, filed an antitrust lawsuit against the largest chain of affiliated competitors in its New York territory.[111] Ultimately, it sold its distribution business to its competitors.

The dispute between Yankee Entertainment Sports (YES) and Cablevision is another example.[112] YES alleges and provides facts to support its claim that the refusal to provide nondiscriminatory carriage is part of a scheme to prevent competition in sports programming[113] and preserve Cablevision's local monopoly in distribution.[114] It documents a long history of threats to foreclose markets as a lever against programmers back to the 1980s.[115] The demands of the operator include demands for equity[116] and exclusivity.[117] "Bargaining" with a dominant distribution incumbent involves take-it-or-leave-it-threats[118] that offer inferior placement,[119] discriminatory prices,[120] or exclusion from carriage. Programmers have little bargaining power,[121] particularly since denial of access to 40 percent of the market renders new programming unviable.[122]

The market structure that conveys the leverage to the distributors is precisely described by YES. There is little direct competition in distribution, with Cablevision having a

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[111] Viacom International V. Telecommunication Inc., et. al. United States District Court of Southern New York, September 23, 1993.
[112] Yankee Entertainment Sports, *Complaint*, May 5, 2002.
[113] Yankee Entertainment Sports, 2002, para.1, 12.
[114] Yankee Entertainment Sports, 2002, para., 2, 13.
[115] Yankee Entertainment Sports, 2002, para. 16, 29.
[116] Yankee Entertainment Sports, 2002, para. 16, 114.
[117] Yankee Entertainment Sports, 2002, para. 66.
[118] Yankee Entertainment Sports, 2002, para. 70.
[119] Yankee Entertainment Sports, 2002, paras. 53, 67.
[120] Yankee Entertainment Sports, 2002, para. 69.
[121] Yankee Entertainment Sports, 2002, para. 89.
[122] Yankee Entertainment Sports, 2002, para. 107.

90 percent market share,[123] which remains insulated behind barriers to entry.[124] Market power has been built and reinforced by acquisition of distribution and programming.[125] Regional market power through clustering plays a critical role[126] particularly for advertising markets.[127] Dominating specific programming categories generates both high profits and provides leverage to undermine competitors.[128] Cable operators have recently added bundling of high speed Internet to their arsenal of anticompetitive practices[129] and reinforced it with anticompetitive contracts.[130] The pattern is being repeated by Cablevision in withholding sports programming in New York[131] and Comcast battling with an independent sports programmer in the Baltimore-Washington area.[132]

Other examples of resistance to entry of programming that might compete with the marquee offerings of the vertically integrated incumbent programming abound, including

[123] Yankee Entertainment Sports, 2002, para. 64.
[124] Yankee Entertainment Sports, 2002, para. 36-40.
[125] Yankee Entertainment Sports, 2002, para. 39.
[126] Yankee Entertainment Sports, 2002, para. 17, 28-29.
[127] Yankee Entertainment Sports, 2002, para. 34-35, 54.
[128] Yankee Entertainment Sports, 2002, para. 30-31.
[129] Yankee Entertainment Sports, 2002, paras. 14, 41.
[130] Yankee Entertainment Sports, 2002, para. 41.
[131] "Petition of TCR Sports Broadcasting Holdings, LLP, to Impose Conditions or, it he Alternative to Deny Parts of the Proposed Transaction," *In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee,* MB Docket No. 05-192, July 21, 2005, p. 16
[132] Declaration of J. Gregory Sidak and Hal J. Singer, in support of "Petition of TCR Sports Broadcasting Holdings, LLP, to Impose Conditions or, it he Alternative to Deny Parts of the Proposed Transaction," *In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee,* MB Docket No. 05-192, July 21, 2005

national[133] and local[134] news programming, home shopping networks,[135] as well as niche programming including educational,[136] arts,[137] and minority[138] programming.

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[133] Waterman and Weiss, 1997, p. 56. Keating, Stephen, *Cut Throat: High Stakes and Killer Moves on the Electronic Frontier* (Boulder: Johnson Books, 1999), pp. 17-18, characterizes the incident as described in this paragraph. Recent comments in the program access proceeding summarize these events aptly: "It is also well known that Fox News Channel ("FNC") owes its very existence to Telecommunications, Inc. ("TCI," since acquired by AT&T), whose agreement to carry FNC on systems serving 90% of TCI's subscribers was critical to the successful launch of the network. Not coincidentally, Fox made FNC available to incumbent cable operators on an exclusive basis. Like the saga of News Corp./EchoStar, FNC's launch and subsequent exclusivity to the cable MSOs is a case study of how the largest incumbent cable operators control the destiny of new programming services, and why programmers sell to cable's competitors at their own risk."

Joint Comments, In *The Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, Federal Communications Commission, CS Dkt. No. 01-290. December 3, 2001, p. 8. "To make room (for Fox News), Malone cleared out existing networks like a bowling ball cracking into the headpin. The arrival of Fox News in Denver pushed Court TV to split the programming day with Spice, a pay-per-view sex network."

According to Grossman, Lawrence. 1997. "Bullies on the Block: Cable Television in New York City." *Columbia Journalism Review*. Jan. 11 1997, Fox fought a similar battle with Time Warner. In 1996, Time Warner (who owned a 20% stake in CNN's parent company, Turner Broadcasting) refused to allow any other cable network to compete with CNN on its cable systems. The nation's largest cable operator at the time, TCI, also owned a stake in CNN, and as a result would also not allow any competitive news services on its systems. Consequently, the U.S. public was denied an alternative news service—despite several attempts at entry from major programmers, e.g. NBC, into the 24-hour news channel business—until the consent decree in the merger of Time Warner and Turner forced the cable operators' hands.

Heidi Przybyla, "BBC uses D.C. as Beachhead for American Invasion," *Washington Business Journal*, suggests that even the BBC was stymied by MSOs who had other cable news programming interests. The BBC was prevented by cable MSOs from establishing a cable news channel as far back as 1991. In 1998, the BBC announced it hoped to form agreements with cable operators to carry BBC World, its international news service, within the next two or three years. A CNN spokesman, Steve Haworth, is quoted as saying, "Competition is always good for journalism, but I think that the BBC will find this to be a very tough marketplace for them. Remember, this is a second attempt for them," referring to BBC World's unsuccessful first attempt to gain US cable distribution. BBC World was launched in 1991 but only made its first appearance in the United States in 1997 after it made a deal with 25 public television stations for them to carry daily news bulletins. BBC, as the Commission knows, was only able to secure some digital distribution after it partnered with MSO-linked Discovery Channel, creating the BBC America channel.

[134] Breyer, R. Michelle, "CNN-Style channel planned for Austin," Austin *American Statesman*, August 22, 1998. p. D1; Tyson, Kim, "Belo adds KVUE to Texas TV Holdings," *Austin American-States-man*. February 26. 1999. P. A1. In August of 1998, Time Warner Cable announced that it would launch an all-news, 24-hour TV channel in Austin, Texas to be available to 220,000 area subscribers, with the specific intent of focusing on central-Texas news. The A.H. Belo Corporation, a media company that currently owns 18 broadcast television stations and four daily newspapers nationwide (including 4 stations and the *Dallas Morning News* in Texas), had also planned to start a cable news channel during the following year, "AT&T Pulls Plug on BayTV News Network," Multichannel News, July 9, 2001.

[135] Waterman and Weiss, 1997, p. 73; Davis, 1998, p. 143.

[136] Waterman and Weiss, 1997, p. 65; Davis, 1998, p. 97

[137] "Barry's New Baby," *Cablevision*, June 11, 2001.

[138] "Minority Nets Continue Distribution Push," *Multichannel News*, December 3, 2001, "BET's Lee Searches for Viacom Synergies," *Multichannel News*, December 3, 2001.

Overbuilders have faced vigorous efforts to prevent competition through exclusion from access to programming and regulatory tactics of incumbent cable operators.[139] Comcast has shifted some sports programming to terrestrial delivery, thereby avoiding the open access requirement of the 1992 statute. As cable operators become larger and more clustered, this strategy will become increasingly attractive to them. Specific areas where such programming has been denied are Phoenix, Kansas, Philadelphia and New York. The denial of access to marquee sports programming can have a devastating effect, with satellite providers in markets where foreclosure has occurred achieving a market penetration only one-quarter of the national average.[140]

Integrated MSOs wield immense power against smaller cable companies, exploiting loopholes in the program access rules.[141] For the smaller entities, the current refusals to deal are not limited to sports programming. Other services have been denied, such as video-on-demand.[142]

Second, where the large MSOs do not have direct ownership of video services, they have obtained exclusive arrangements, thereby denying competitors and potential competitors

[139] *RCN Telecom Service of New York, Inc. v. Cablevision Corp., DIRECTV v. Comcast; EchoStar v. Comcast.* Problems can also occur on an event-by-event basis (see Everest, 2001, p. 4; Gemini Networks, 2001, p. 3.

[140] Joint Comments, p. 14.

[141] American Cable Association, "Comments of the American Cable Association." In *The Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, Federal Communications Commission, CS Dkt. No. 01-290, December 3, 2001, p. 15.

[142] "Comments of Everest Midwest Licensee LLC dba Everest Connections Corporation." In *the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, Federal Communications Commission, CS Dkt. No. 01-290, December 3. 2001, p. 6.; "Comments of Qwest Broadband Services, Inc." In *The Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution: Section 628 (c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, Federal Communications Commission, CS Dkt. No. 01-290, December 3. 2001, p. 4.

access to programming.[143] The exclusionary tactics apply not only to head-to-head cable operators and satellite providers, but also to DSL-based providers seeking to put together a package of voice, video, and data products. Bundling is critical to controlling entry into the emerging digital multimedia market.[144]

Third, because the dominant MSOs are so large, they can influence important programmers not to sell to competitors or potential competitors. As the Commission noted, Ameritech and the WCA found that they were cut off from programming.[145] The list could go on and on.[146]

The problem is not simply one of complete exclusion. Dominant, vertically-integrated MSOs can inflict "discriminatory or excessively burdensome terms and conditions of programming distribution."[147] Recent comments in the program access proceeding point to an even more stark demonstration of the power of cable to engage in content discrimination.[148]

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[143] Everest, p. 6, American Cable Association, 2001, p. 15.

[144] Comments of the Competitive Broadband Coalition, *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, Cable Services Bureau Dkt. No. 01-290, at 10-11 [Dec. 3, 2001]), p. 11.

[145] Federal Communications Commission, 2001a, para. 28

[146] Joint Comments, 2001, p. 8.

[147] Qwest, 2001, p. 3; Dertouzos and Wildman, 1999.

[148] Joint Comments, 2001, p. 9.

VI. COUNTING SUBSCRIBERS TO SET A NATIONAL CAP

The Commission raises two issues that revolve around the nature of the subscribers served, beyond the mere counting of homes passed. It asks whether clustering and other characteristics of cable ownership should be considered in setting a horizontal limit.[149] Similarly, it asks about the role of DBS in providing an alternative means of distribution for video programming.[150]

Consumer groups have argued that clustering reinforces the market power of the cable operators at the point of sale. They have also challenged the decision to include DBS in the total count because of the unique characteristics of DBS as a distribution mechanism.

The behavior of the industry and the empirical evidence reviewed below indicate that these are important considerations. The Commission's prior approach to the horizontal limit, which took no notice of the markets in which subscribers are located dramatically underestimates the market power of some cable operators. It allows cable operators to exercise far more power to impede unaffiliated programmers than the Commission asserts.

Answering these questions based on the reality of the industry, rather than theory and speculation, demonstrates that the current industry structure strangles independent production because the market power of cable operators is far greater than a simplistic count of subscribers indicates. The growth of satellite subscribers has done little to discipline the market power of the cable operators. They continue to raise prices, force consumers to buy huge bundles and discriminate against independent programmers. The claims that the industry is dynamically competitive or has been transformed by the advent of digital

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149 ¶33.
150 ¶ 30.

distribution arguments are without merit. Cable operators continue to possess substantial market power through their dominance of distribution. This market power is evidenced as sellers of programming to the public and buyers programming from video producers.

A. CLUSTERS

The importance of regional programming is highlighted in the Eleventh Annual Report. Regional sports networks represent about 40% of total regional networks, while regional news networks represent another 40%.[151]

A recent FCC staff white paper on DBS-cable substitution found, “firm-specific attributes and demographic variables that influence consumer choice and switching costs that appear to affect consumers’ desire to switch from one service to another.” Notably, the control of regional programming affected consumers’ desire to switch from cable to DBS:

> We also find that DBS penetration is lower where cable operators carry regional sports channels.
>
> This is likely due to a combination of factors discussed above. Two of the factors may involve cable operators limiting DBS operator access to regional sports networks. If this is true, cable operators may be able to offset competitive pressures from DBS, and thus may be able to impose larger price increases without losing subscribers to DBS where they are able to transmit vertically-integrated regional sports networks terrestrially, or are able to reach exclusive carriage agreements with non-vertically-integrated regional sports networks.[152]

As shown in the Eleventh Annual Report, cable operators continue to concentrate their systems regionally in “clusters” through the purchase and sales of MSOs or through “swapping.” The Report found that clustering subscribers has increased in recent years.[153]

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[151] Eleventh Annual Report, ¶¶166-169.
[152] P. 21
[153] Eleventh Annual Report, ¶141-142

The Eleventh Annual Report also shows that small and rural areas represent distinct markets that are at a competitive disadvantage in acquiring programming. Operators of small systems report that they have difficulty obtaining programming due to higher costs (programming is not available on terms similar to those received by large MSOs) and because of tying requirements by programmers.[154]

2. The Importance of the Top 25 Markets

A second aspect of clustering that plays an important role in the horizontal limits analysis is the special role of large urban markets in the industry. The reasons offered for the importance of the large designated market areas include the attractiveness to advertisers of a high-income trend setting population, as well as the presence of the major media.

> In addition to the number of viewers, advertisers consider the markets to be important (indeed even disproportionately to their subscriber numbers) for a number of reasons including product trend-setting, higher per capita disposable income, and the presence of major press. Networks that do not substantially penetrate the top markets are at a severe disadvantage in the competition for advertising dollars relative to similar networks which do.[155]

While there are many intangible elements to this characteristic of the industry, there is one area in which it should be visible. Advertising revenue should be higher in the more highly valued markets. Exhibit 18 plots the distribution of TV households and TV ad revenue across the designated market areas, which are the standard definition of TV markets used in the industry. There is no doubt that the top markets account for a larger share of revenues than households. To assess the importance of this phenomenon, we have calculated the ratio of revenue to population – essentially the market-wide power ratio (see Exhibit 19).

[154] Eleventh Annual Report, ¶186
[155] TAC, Comment, p. 28.

The top eleven markets all have a substantial premium of ad revenues above TV households. These markets account for 31 percent of the TV households, but 41 percent TV ad revenue, a premium of over 33 percent. Six of the next 14 markets have a premium, but the overall premium is about the same. That is, the top 25 markets have 49 percent of TV households and 59 percent of the ad revenue.

B. ALTERNATIVE DISTRIBUTION MECHANISMS

The Commission once again seeks comment on the appropriate definition of the programming distribution market.[156] We agree with the Commission's tentative conclusion that other physical conduits, such as theatrical showings in movie theaters and sales and rentals of VHS tapes and DVDs, should not be included in an analysis of the distribution market.[157] While DVD sales are on the rise, they do not represent an alternative to network programming. Rather, they are a complement to network programming. More important, two of the most popular types of MVPD programming, sports and news, do not lend themselves to substitution via DVDs. Live, current events and sports programming will not be replaced by VHS and DVD sales.

We disagree with the Commission's previous approach to DBS. Despite the ranking of DirecTV and EchoStar in the top five MVPDs today, DBS has grown significantly by serving markets that cable does not. DBS distribution is not a substitute for cable distribution because of the pattern of its development. Therefore, if the Commission continues to include DBS in its analysis, it should discount DBS subscribers.

1. DBS Is Not A Full Competitor To Cable

[156] Second Further Notice ¶67-68
[157] Second Further Notice ¶68

Confusing separate geographic markets and product market segments served by different technologies leads to an inappropriate conclusion about intermodal competition. In fact, satellite drew its subscribers from places that cable had not gone. A very substantial segment of the satellite market exists in places not served by cable. Moreover, satellite was the only digital service available for a considerable period of time. In other words, cable was not losing subscribers to satellite; satellite was expanding the market. It never competed for the bulk of cable's basic/expanded basic customer base.[158] Cable's offering of digital service is growing much faster than satellite's comparable service. The addition of high-capacity digital cable and cable modem Internet services allows cable operators to attack the high-end niche that satellite occupies.[159] Cable will be able to leapfrog satellite at the high-end of the market, particularly when it is bundled with high-speed Internet access. Satellite will be at an increasing disadvantage, as it does not have an Internet offering of equal quality and price to deliver over the same facilities.

Moreover, GAO found that in contrast to head-to-head, wireline competition, which lowers cable bills by $5 per month, competition from direct broadcast satellite (DBS) lowers bills by a mere $.15, according to the GAO.[160] The FCC's econometric analysis does not find even this small price effect. It finds a statistically significant effect in the opposite direction.[161]

To the extent that satellite has any competitive effect, it drives cable operators to offer more channels, but this effect stems from the decision of satellite to offer local programming.

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[158] Bazinet, Jason B., *The Cable Industry.* (J.P. Morgan Securities, Inc. 2001), p. 4.

[159] Boersma, Matthew., "The Battle for Better Bandwidth – Should Cable Networks Be Open?" *ZDNet,* July 11. 1999.

[160] U.S. GAO, 2003, Appendix IV.

[161] FCC, *Report on Cable Prices,* April 4, 2002, Attachment D-1.

Where satellite offers local programming, cable operators offer about 5.4 percent more cable channels. Thus, satellite appears as a niche product that cannot discipline cable pricing abuse for the vast majority of cable subscribers who take only basic and expanded basic.[162] It certainly has not reversed the pattern of discrimination against independent programmers documented earlier.

It is now quite clear that DBS cannot be considered a full competitor for cable from the point of view of the consumer. The evidence shows that it does not discipline cable with respect to price.

2. DBS Subscribers Are Overvalued In the FCC Calculation

The weakness of DBS as a distribution mechanism has been demonstrated in the behavior of the dominant DBS owner, who also happens to be the owner of one the major national broadcast networks. As the America Channel notes in its recent filing, when Fox news sought to launch a business channel, it could not rely on its DBS distribution network. As the *Wall Street Journal* noted, "people familiar with the situation say Mr. [Rupert] Murdoch didn't want to go ahead until he had an agreement with Time Warner Cable, because it controls the crucial Manhattan market."[163]

Beyond the specific issue of the New York market, DBS continues to have a substantially different subscriber base. It is much less urban and much more rural (see Exhibit 20). The share of satellite subscribers in the top eleven DMAs is 27 percent, compared to 33 percent of cable's subscribers in those markets. The difference is substantial in terms of market value. On a simple comparison, cable has 18.4 million more subscribers than satellite in the top eleven markets. On a revenue-weighted basis, it has 22.8 million more

[162] Cooper, 2002, pp. 21-32.
[163] Cited in TAC, p. 34.

subscribers. On a national average basis, satellite subscribers reside in designated market areas whose ad revenue is about 10 percent less than the national average, with the bulk of the difference coming in the top 11 markets.

The underlying limitation of DBS as a competitor to cable can be readily seen in the distribution of subscribers. Satellite has made its largest penetration in smaller, rural markets, which carry much less weight in the industry. Exhibit 21 underscores this point by examining markets where cable's share exceeds the level typically associated with monopoly power. This is generally put in the range of a 65 to 70 percent market share.

Conversely we look at markets where satellite's market share is above 30 to 35 percent. These markets contain about 16.1 million MVPD subscribers or 17 percent of the national total. Satellite's market share is above 35 percent of MVPD (indicating cable's is less than 65 percent) in markets that have 6.9 million MVPD subs, or about 7 percent of the national total. Cable's market power remains above the monopoly level in the vast majority of markets.

Exhibit 21 shows the individual markets where cable has a less than 65 percent market share. These are the 28 markets where satellite has its largest market share. We contrast this to the 28 markets where cable has its largest market share. The difference is striking, on average, cable's best markets are four times as large.

C. COMCAST

The importance of large urban markets and the weakness of satellite as a competitor, both at the point of sale and as a means of distribution for independent programming, converge in the case of Comcast. These two factors are extremely important in evaluating the market power of Comcast. Comcast has been flirting with the national limit since it acquired

AT&T and it will be well above the cap if the Commission recognizes the importance of these two factors (see Exhibit 22) in their market measurements.

Comcast has clustered its systems in the dominant designated market areas. About 60 percent of its subscribers reside in the top 11 DMAs. Eighty percent of its subscribers reside in the top 25 DMAs. Thus, it has a heavy premium in terms of advertising clout. This gives it greater leverage over programmers than its subscriber count would indicate.

One interesting comparison is between Comcast and the total of satellite subscribers (see Exhibit 23). Comcast owns systems that pass approximately 21.5 million subscribers. Weighted by advantage of advertising revenue in the top 11 markets, those subscribers are equal to 24.8 million. DBS serves approximately 21.3 million subscribers, but they are underrepresented in the top 11 DMAs. This disadvantage, *vis-à-vis* cable, would lower the DBS effective count to just over 17 million. In other words, instead of being equal to Comcast in simple subscriber count, DBS would be about two-thirds the size of Comcast on an ad revenue weighted basis, if the premium on viewers in the top 11 DMAs is included.

VII. THE OPEN FIELD, TWO FIRM APPROACH SHOULD BE USED TO ESTABLISH A MARKET-WEIGHTED CAP BETWEEN 20 TO 30 PERCENT

In our 2001 comments, CFA and CU supported using the theory of monopsony to demonstrate how a large purchaser of programming could cause harm to the market, providing numerous, widely accepted economic theories that state a monopsonist would have the power to decrease programmers' output and the prices they receive. Further, CFA and CU showed that these theories apply to cable operators' relationship to programmers.[164] In the Second Further Notice the Commission requests comment on the appropriateness of applying standard monopsony arguments to the analysis of the specific nature of the programming market.[165]

The empirical evidence reviewed in these comments demonstrates that independent programmers are being discriminated against in carriage decisions. The open field approach based on actions of the two largest firms that could result from a horizontal limit remains valid. As we have shown, no national program currently attains the critical threshold of carriage if either of the two largest firms in the industry denies it carriage.

Since these finding are consistent with the monopsony market structure analysis we presented in our earlier comments, we update that presentation here.

The monopsony power of cable systems has not been reduced in the past four years. The substantial market share of the dominant firms in the national market for programming is reinforced by horizontal concentration and vertical integration. Given the nature of television

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[164] CFA Comments. at 26, 28 (citing *FTC v. H.J. Heinz Co.*¸ 246 F.3d 708, 715 (D.C. Cir. 2001); *United States v. Philadelphia National Bank*, 374 U.S. 270 (1966)).

[165] Second Further Notice, ¶87

programming, with its high first-copy costs, producers need to achieve a large audience quickly to survive. By controlling a substantial number of eyeballs, cable operators can make or break programming. Exercising monopsony power as buyers, they can squeeze programmers by holding down what they pay or by insisting on sharing the profits (demanding equity stakes). Once they become vertically integrated, their incentive to squeeze out rivals is reinforced. The fewer alternatives that are available for specialized inputs (creative producers), the easier it is to control the programming market.

A. Analytic Framework

The public policy goal we have outlined in theory and that Congress has clearly articulated in its directives is to prevent the abuse of market power. This section develops the concept of market power.

The primary measure of that harm is in the impact it has on prices and efficiency, although increasing attention is paid to quality and innovation. Price analysis focuses on the firm's ability to set price above cost to achieve above-normal profits. Starting from this observation helps to focus the discussion of factors that result in the abuse of market power.

The discussion of antitrust is almost always framed in terms of monopoly power – or the lack of sufficient competition to discipline sellers resulting in their ability to set prices above costs in a market. A similar concern exists with monopsony power.

The analytic framework is established with primary reference to the work of two prominent "liberal" economists – Scherer and Ross – and two prominent "conservative" economists – Landes and Posner. The discussions are framed in terms of the Lerner index, to which earlier Notices in this proceeding referred,[166] as the central measure of market power.

[166] ¶ 63

The decomposition of that index into the key market structure characteristics – market shares, elasticities of supply and demand – elucidates the fabric of the concept of market power.

1. Conceptualizing Market Power

The conceptual depiction of the exercise of market power is presented in its simplest form in Exhibit 24 and Exhibit 25. Exercising market power allows suppliers to set prices above their costs to achieve above normal profits. Scherer and Ross describe this concept as follows, in the terms identified in Exhibit 24.

The profit-maximizing firm with monopoly power will expand its output only as long as the net addition to revenue from selling an additional unit (the marginal revenue) exceeds the addition to cost from producing that unit (the marginal cost). At the monopolist's profit-maximizing output, marginal revenue equals marginal cost. But with positive output, marginal revenue is less than price, and so the monopolist's price exceeds marginal cost. This equilibrium condition for firms with monopoly power differs from that of the competitive firm. For the competitor, price equals marginal cost; for the monopolist, price exceeds marginal cost.…

> [The] Figure .. illustrates one of the many possible cases in which positive monopoly profits are realized; specifically, the per-unit profit margin P_3C_3 times the number of units OX_3 sold. As long as entry into the monopolist's market is barred, there is no reason why this profitable equilibrium cannot continue indefinitely.[167]

Landes and Posner – two prominent conservative economic thinkers -- offer a similar concept, described as follows with reference to Exhibit 25. [168]

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[167] Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990, Third edition), pp. 21-22; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1997, Fourth edition), presents a similar view.

[168] Landes, W. M. and R. A. Posner, "Market Power in Anti-trust Cases," *Harvard Law Review*, 19: 1981. Interestingly, the first economic text cited by Landes and Posner (at note 6) was the 1980 edition of Scherer and Ross.

> Our concept of market power is illustrated in [Exhibit 25] on the next page, where a monopolist is shown setting price at the point on his demand curve where marginal cost equals marginal revenue rather than, as under competition, taking the market price as given. At the profit-maximizing monopoly price, pm, price exceeds marginal cost, C', by the vertical distance between the demand and marginal cost curves at the monopolist's output, Qm; that is, by pm -C'.

Antitrust law and practice recognizes that monopoly and monopsony are flip sides of the same anticompetitive coin.

> The mirror image of monopoly is "monopsony." A monopsonist is a monopoly buyer rather than seller. Although most antitrust litigation of market power offenses has involved monopoly sellers rather than buyers, monopsony can impose social costs on society similar to those caused by monopoly.[169]

> Monopsony is often thought of as the flip side of monopoly. A monopolist is a seller with no rivals; a monopsonist is a buyer with no rivals. A monopolist has power over price exercised by limiting output. A monopsonist also has power over price, but this power is exercised by limiting aggregate purchases. Monopsony injures efficient allocation by reducing the quantity of the input product or service below the efficient level.[170]

Monopsony power has received less attention in antitrust practice for a variety of reasons. Monopoly and monopsony frequently occur together and monopoly is the more inviting antitrust target.[171] The impact of this exercise of market power, in the first instance,

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[169] Hovenkamp, Herbert, *Federal Antitrust Policy: The Law of Competition and Its Practice,* Hornbook Series (West Group, St.Paul; 1999), Footnote 13, p. 13-14.

[170] Lawrence Sullivan and Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook,* Hornbook Series (West Group, St. Paul, 2000) at 138-139.

[171] Id. at 138-139.

> Antitrust law has been slow to develop a coherent set of principles for assessing monopsony power. One reason for this is that many firms possessing monopsony power in the purchase of goods or services also possess monopoly power when the goods or services are resold. For example, the monopsony power that a cable TV franchise possesses in purchasing television programming becomes monopoly power when that programming is distributed to the franchise's cable subscribers. When a monopsonist is also a monopolist, attacking the monopoly conduct may be the politically more popular enforcement option because the monopoly conduct has a direct impact on the price paid by consumers.
>
> Although there is no theoretical basis for assuming that monopsony power is less injurious to consumer welfare than monopoly power, the direct injury that monopsony occasions is to the seller of goods and services, not to the end consumer. To the extent antitrust chooses politically popular enforcement initiatives, it is understandable that it would focus on a

may be to lower prices paid by monopsonist buyers, which poses a conundrum for antitrust law, which usually focuses on price increases.[172]

However, the leading antitrust texts recognize that a careful economic analysis of the abuse of monopsony power leads to the more traditional and typical anticompetitive effects.[173]

> The monopsonist reduces its buying price by reducing the amount of some input that it purchases. If the input is used in the output in fixed proportions, then the output must be reduced is well. This suggests two things: (1) the monopsony buyer that resells in a competitive market will charge the same price, but its output will be lower than if it were a competitive purchaser; (2) the monopsony buyer (or cartel) that resells in a monopolized (or cartelized) market will actually charge a higher price than if it were a competitive purchaser.[174]
>
> But antitrust attacks on monopsony abuses do occur and enforcement efforts can lead to a potentially wider interest in market power abuses of powerful buyers.
>
> For example, in addressing vertical restraints, the theoretical literature has increasingly recognized that some restraints are a product of market power in the hands of downstream dealers that buy from their suppliers. Increased public interest also followed the Federal Trade Commission's pursuit of a vertical restraints case against Toys "R" Us alleging that the powerful retail chain exercised monopsony power in preventing suppliers from selling on equal terms to other retailers.[175]

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monopoly that raises prices to consumers rather than a monopsony that depresses prices to sellers.

[172] Hovenkamp, at 14.

By reducing its demand for a product, a monopsonist can force suppliers to sell to it at a lower price than would prevail in a competitive market... If the price is suppressed they will reduce output to a level that once again equals their marginal costs. In any event, both price and output will fall below the competitive level when the buyer is a monopsonist. Some productive assets will be assigned to products that would have been the supplier's second choice in a competitive market. As a result, monopsony allocates resources inefficiently just as monopoly does.

The important policy implication of monopsony is that it reduces rather than increases output in the monopsonized market. Many federal judges have failed to see this. The consumer welfare principle in antitrust, or the notion that the central goal of antitrust policy should be low prices, has often suggested to courts that monopsony is not all that important an antitrust policy concern.

[173] Roger D. Blair and Jeffrey L. Harrison, "Antitrust Policy and Monopsony," *Cornell L. Rev.* 1991.

[174] Id. at 15.

[175] Sullivan and Grimes, at 139.

In fact, not only is monopsony power the object of traditional antitrust practice,[176] but also it has a very long-standing presence in seminal cases.

> Although the Court did not use the term "monopsony," it has not hesitated in a number of cases to apply Section 2 of the Sherman Act to monopsony power. An early example of this was the 1911 Standard Oil case, involving allegations that Standard Oil used its monopsony power over the railroads to dictate the terms by which the railroads would deal with rivals of Standard Oil. Standard Oil was by no means the sole purchaser of railroad transportation, but its substantial position in the oil industry and the relative importance of a railroad maintaining its petroleum business probably gave Standard Oil a substantial measure of monopsony power. The Justice Department directed another Section 2 attack on monopsony power at movie theater owners in United States v. Griffith. In Griffith, the defendants owned movie theaters in towns in Oklahoma, Texas and New Mexico, some of them in competition with rival theaters in the same town, others operating as the sole theater in town. The Justice Department successfully invoked Section 2 in condemning the defendants' use of their buying power to gain favorable terms from movie distributors...
>
> The unspoken premise of Griffith is that the Court will apply the same standards of proof to a monopsony claim under Section 2 that it would apply to a monopolization claim.[177]

Referring to Exhibit 26, Hovenkamp discusses monopsony power as the monopoly power "turned upside down," but leading to the same result – higher prices – when it is combined with monopoly power.

Consider this illustration.

> A monopoly manufacturer of aluminum is also a monopsony purchaser of bauxite.
>
> "Marginal outlay" refers to the total additional cost that the monopsonist incurs when it purchases one more unit. By contrast, "marginal cost" refers to the cost of the one additionally purchased unit. While the monopolist generally maximizes profits by equating marginal cost and marginal revenue, the monopolist that is also a monopsonist in an input market maximizes profits by

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[176] John Lauck, "Toward an Agrarian Antitrust: New Direction for Agricultural Law," *N.Dak. L. Rev* 499, 1999; John J. Curtin, Daniel L. Goldberg and Daniel S. Savrin, "The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a 'Gatekeeper' Analysis of Retailer Market Power Under U.S. Antitrust Law," 40 *B.C. L. Rev.* 537 (1999).

[177] Id. at 139.

equating marginal outlay and marginal revenue.

> [Exhibit 26] illustrates. It shows the relevant demand (D), marginal revenue (MR), marginal cost (MC) and marginal outlay (MO) curves of a firm that purchases a single input in a monopsonized market and resells this input in a monopolized market. Considering the firm simply as a monopolist in the output market, it would equate MC and MR. The monopoly price would be Pm and monopoly output would be Qm. However, if the monopolist is also a monopsonist in the market for the input and its marginal cost curve slopes upward, then its marginal outlay curve will slope upward as well, only twice as steeply. That is, the relation between marginal cost and marginal outlay is exactly the same as the relation between demand and marginal revenue, except turned upside down. The monopolist/monopsonist maximizes its profits by equating MO and MR. This yields a monopoly/monopsony price on Pmm' and an output of Qmm.[178]

Even if the sole effect of monopsony power were to reduce the prices paid to programmers who were its targets, it would be objectionable under the 1992 Act, since Congress expressed great concern with promoting diversity and that the reduction of output of suppliers (programmers) would be an affront to the Act.

B. SPECIFICITY OF MONOPSONY FRAMEWORK TO THE HORIZONTAL LIMIT

Sullivan and Grimes note that the exercise of monopsony power is more likely in specialized products. They specifically include cable TV programming in the list of markets likely to be afflicted with the exercise of monopsony power.

> Monopsony is thought to be more likely when there are buyers of specialized products or services. For example, a sports league may exercise monopsony (or oligopsony) power in purchasing the services of professional athletes. An owner of a chain of movie theaters, some of which are the sole theaters in small towns, may have monopsony power in the purchase or lease of movies. Cable TV franchises may exercise monopsony power in purchasing television channels that will be offered to their subscribers. [179]

> At the same time, the abuse of monopsony power is more likely when the product is undifferentiated. Where products are relatively undifferentiated and capacity primarily distinguishes firms and shapes the nature of their

[178] Hovenkamp, Footnote 13, p. 15.
[179] Sullivan and Grimes, p. 138.

competition, the merged firm may find it profitable unilaterally to raise price and suppress output. The merger provides the merged firm a larger base of sales on which to enjoy the resulting price rise and also eliminates a competitor to which customers otherwise would have diverted their sales. Where the merging firms have a combined market share of at least thirty-five percent, merged firms may find it profitable to raise price and reduce joint output below the sum of their premerger outputs because the lost markups on the foregone sales may be outweighed by the resulting price increase on the merged base of sales.[180]

In some respects, video programming is differentiated, in others it may not be. Earlier notices in this proceeding discuss the question of entry by imitation in genres.[181] The development of marquis shows and strong brands suggests differentiation. The development of look-a-likes suggests a lack of differentiation.

The 35 percent figure, given for routine monopsony power concerns, is well grounded in antitrust practice in the sense that mergers have been successfully challenged at this level.[182] Similarly, a 30 percent limit is well grounded in monopsony complaints. For example, in the Toys R Us case noted above, the market controlled was "20% of the national wholesale market and up to 49% of some local markets."[183]

C. EVIDENCE REQUIRES HORIZONTAL LIMIT OF 20-30%

This review of theoretical and practical literature on horizontal market structure leads to a clear conclusion that is reflected in much public policy. Based on decades of analysis, the expectation is that certain types of market structures are sufficiently conducive to anticompetitive outcomes to be a source of concern. The 30 percent horizontal limit used by the FCC in the past is well grounded in this literature and practice.

[180] Merger Guidelines, Section 2.22.
[181] ¶ 17
[182] Peter Asch, *Industrial Organization and Antitrust Policy* (John Wiley, New York; 1983), Chapter 14.
[183] *In re Toys "R" Us, Inc.,* FTC No. 9278 (October 13, 1998).

Our analysis in these comments has shown, however, that it should be adjusted for the market location of subscribers. This should be taken into account in two ways: one general, one specific.

1) As a general matter, relative weight of DBS subscribers in assessing effective competition should be discounted. In practical terms, the denominator of the fraction should reflect this discount of DBS subscribers. We recommend a 10 percent discount, which reflects the ad revenue adjusted weight of satellite subscribers.

2) When reviewing a specific transaction, the evidence requires that the market share in the top markets, and the inflated ad revenues such control brings, should be factored into the analysis. In practical terms, the numerator of the fraction – the market share of the merging firm -- should be increased by the ad-weighted premium of the top markets. Absent this adjustment, the true market power of top-market clusters will be ignored to the detriment of consumers and programmers.

These essential adjustments indicate the appropriate limit for horizontal ownership should be between 20-30%. With attribution of cable systems in which Comcast holds a financial interest, the discounting of DBS subscribers and the premium for large DMA subscribers would put Comcast well above the horizontal limit – above it by over 4 million subscribers. Needless to say, its acquisition of Adelphia would run well afoul of the limit.

The necessity of a horizontal limit of 20-30% is demonstrated by market analysis using the open field approach based on the actions of the two largest firms. This public policy must be in place to guard against collusive price inflation and discrimination against independent programmers. These comments illustrate a variety of anticompetitive behaviors that result from the monopsony power of the largest MSOs—regional clustering and exclusive programming restrictions, price gouging through bundles, and the denial of carriage to programmers unaffiliated with MSOs or broadcasters with retransmission leverage. No national program currently attains the critical threshold of carriage if either of the two largest firms in the industry denies it carriage. Meanwhile, as diversity declines, prices and profits go through the roof. Such outcomes run counter to the intention of Congress and the interests of the public.

Before the
Federal Communications Commission
Washington, D.C. 20554

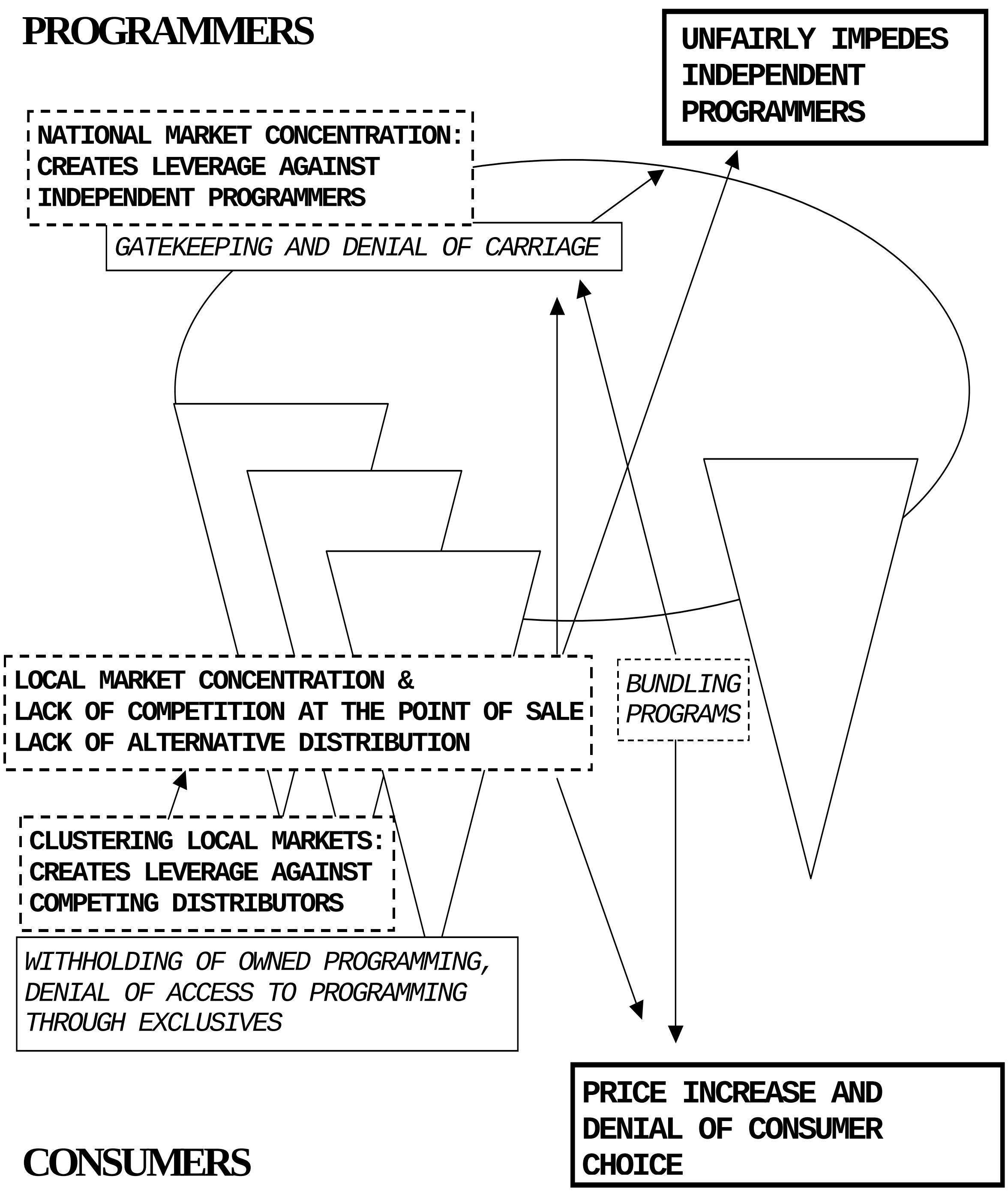
In the Matter of	**)**	
	)	
The Commission's Cable Horizontal and Vertical	**)**	**MM Docket No. 92-264**
Ownership Limits and Attribution Rules	**)**	

EXHIBITS ACCOMPANYING

COMMENTS
of
CONSUMER FEDERATION OF AMERICA ,
CONSUMERS UNION
and
FREE PRESS

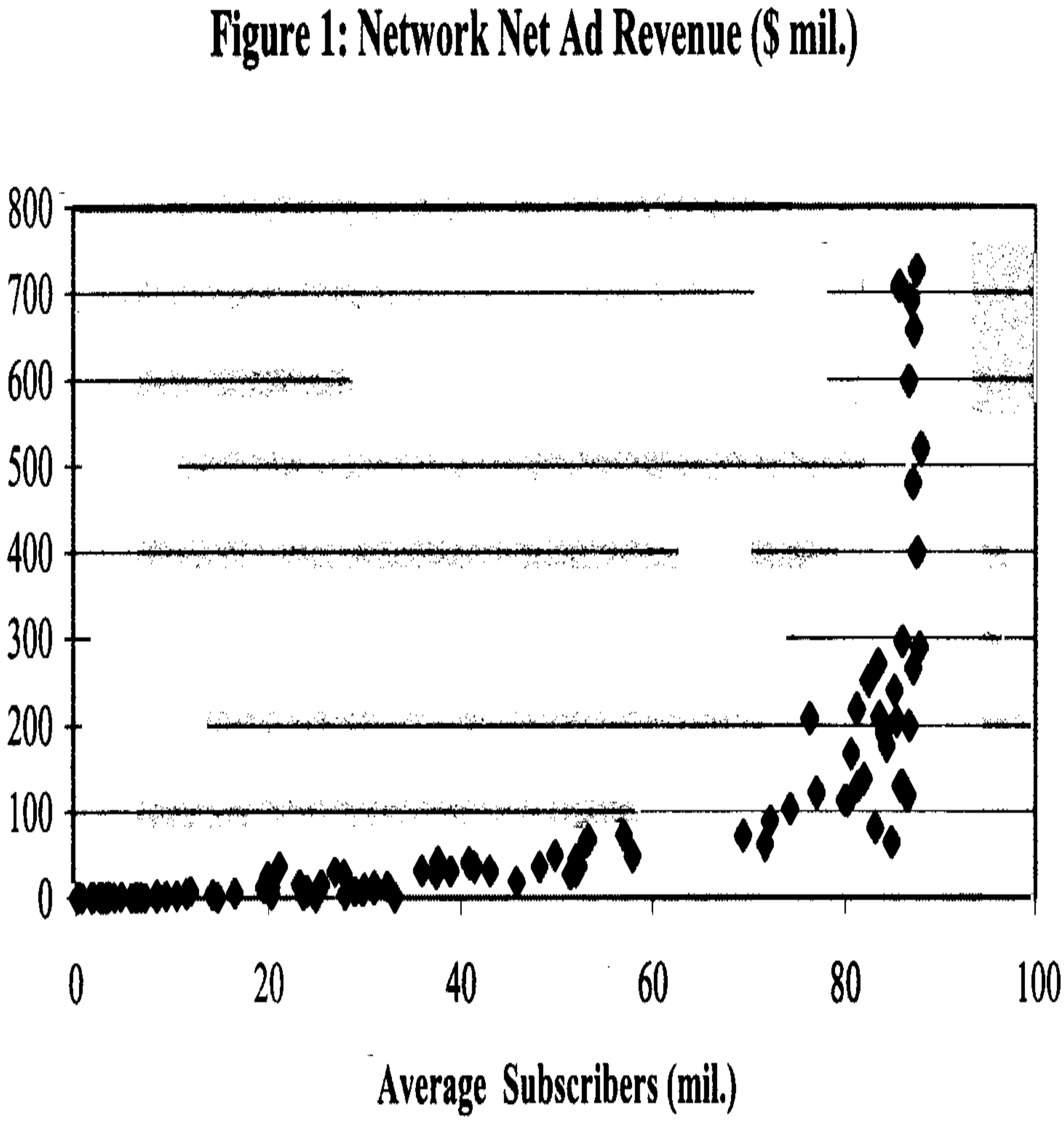
August 8, 2005

Exhibit 1: Anti-Competitive Market Structure and Cable Industry Conduct Harms Independent Programmers and Consumers



Legend: Structure in - - - - **BOLD** ; Conduct in *Italics;* Performance ▬ **BOLD**
▽ Individual cable system; ⬭ national market

Exhibit 2: The Booz Allen Suggestion that Seventy Million Subscribers is a Clear Threshold for Achieving Large Ad Revenues is Supported by Bruce Owen's Data



Source: Bruce Owen and John M. Gale, Cable Networks: Bundling, Unbundling, and the Cost of Intervention, July 15, 2004, p. 32.

Exhibit 3: Independent Programmers are at a Severe Disadvantage in Gaining Carriage Compared to Programmers Affiliated with MSOs or Broadcasters

SUBSCRIBER LEVEL	NUMBER OF NETWORKS AFFILIATED #	UNAFFILIATED #	PERCENTAGE OF NETWORKS AFFILIATED %	UNAFFILIATED %
70 MILLION OR MORE	40	4	91	9
50 TO 70 MILLION	11	3	79	21
25 TO 50 MILLION	24	5	83	17
20 TO 25 MILLION	5	4	56	44

Source: "The America Channel LLC's Petition to Deny," In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee, MB Docket No. 05-192, July 21, 2005, Exhibit 1.

Exhibit 4: New National Affiliated Programs Receive Extreme Preference in Carriage from the Dominant Cable Operators

	INDEPENDENT	AFFILIATED	INDEPENDENT	AFFILIATED
National	#	#	%	%
Total	114	19	100	100
Total Carriage	12	20	11	105
Type of Carriage				
Standard				
Comcast	1	3	1	16
Time Warner	1	4	1	21
Premium				
Comcast	6	8	5	42
Time Warner	4	5	4	26

Source: "The America Channel LLC's Petition to Deny," *In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee,* MB Docket No. 05-192, July 21, 2005 (hereafter TAC Petition), Exhibit 5.

Exhibit 5: Carriage on Dominant MSOs is Necessary for Achieving the Reach Necessary to Attract Advertising Revenues

SUBSCRIBER LEVEL	CARRIAGE ON COMCAST AND TIME WARNER SYSTEMS PERCENT ON SYSTEMS		
	BOTH	ONE	NONE
70 MILLION OR MORE	100	0	0
50 TO 70 MILLION	100	0	0
25 TO 50 MILLION	100	0	0
20 TO 25 MILLION	55	45	0

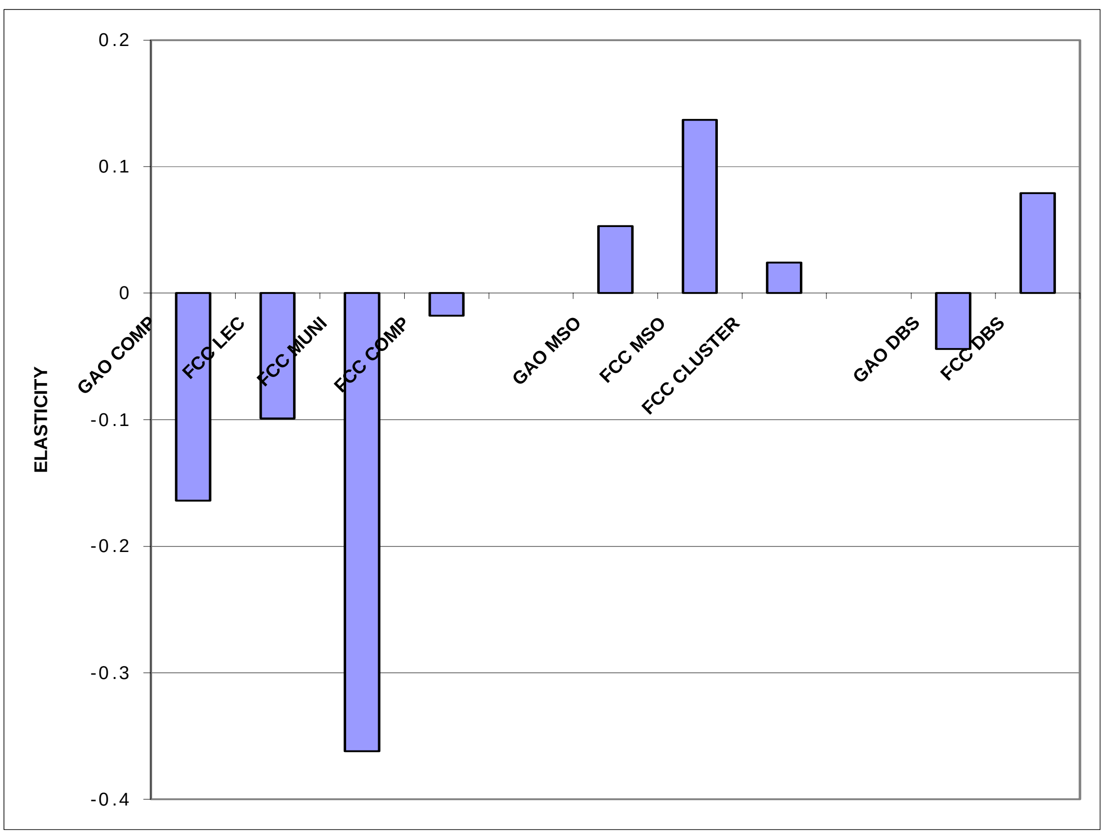
Source: "The America Channel LLC's Petition to Deny," *In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee,* MB Docket No. 05-192, July 21, 2005 (hereafter TAC Petition), Exhibit 5.

Exhibit 6: Trends in MVPD Concentration and Cable Clustering

	CABLE ONLY CR4	CABLE ONLY HHI	CABLE + SATELLITE CR4	CABLE + SATELLITE HHI	CLUSTERS % OF SUBS
1992	48	928			
1994	47	898			31
1996	61	1326	53	923	53
2000	65	1303	53	954	79
2004	67	1495	58	1097	81

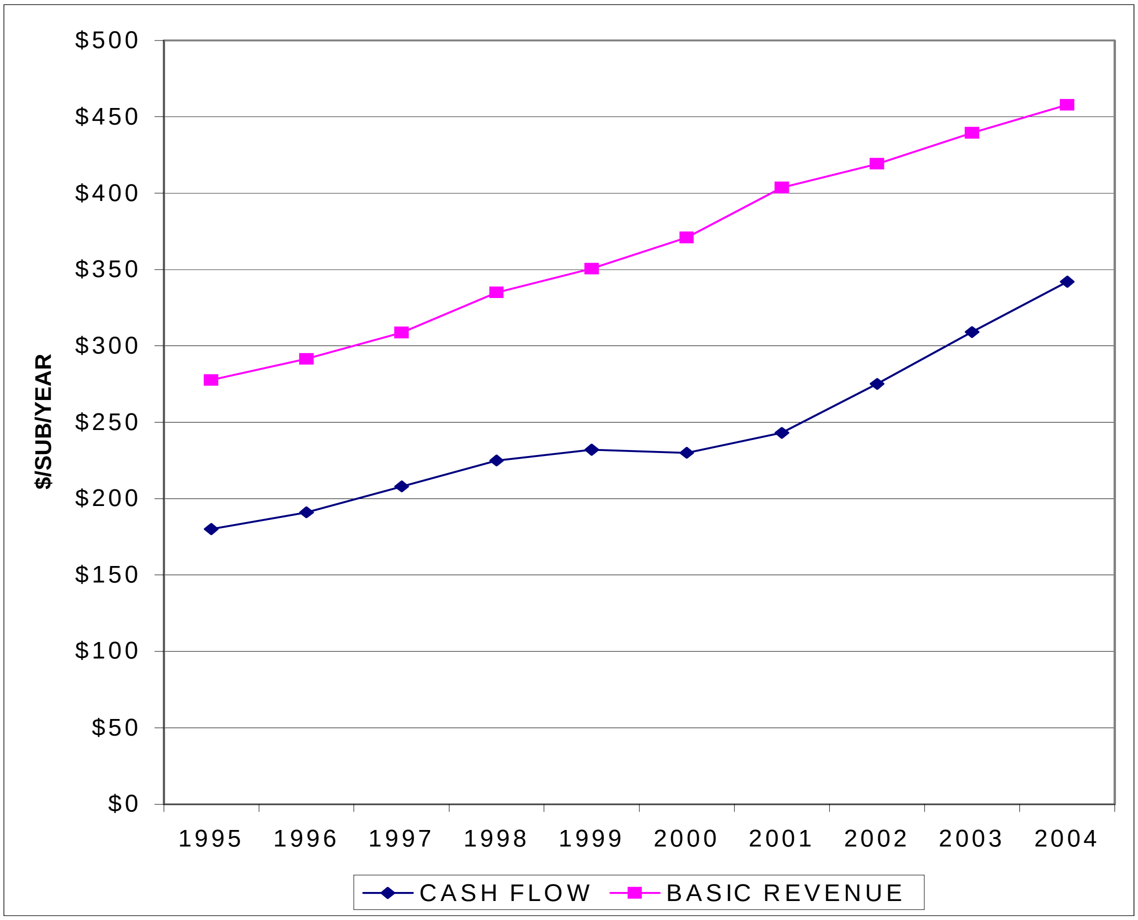
Source: Federal Communications Commission, *Annual Assessment of the Status of Competition in the Market for Video Programming*, various issues. The figures for 2004 do not appear to attribute indirect Comcast holdings in other cable operating systems.

Exhibit 7: Impact Of Market Structure Characteristics On Monthly Rates



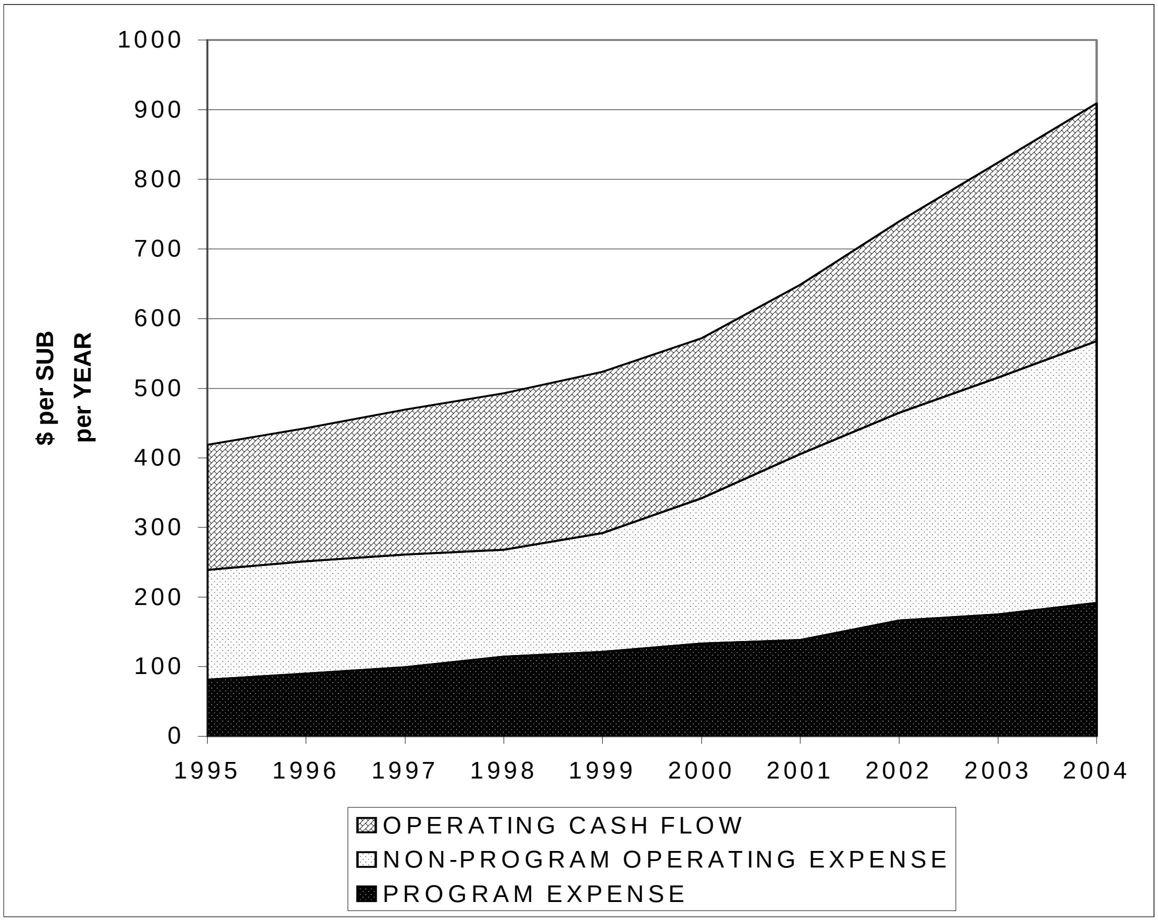
Sources: Federal Communications Commission, *Report on Cable Prices*, April 4, 2002, Attachment D-1; General Accounting Office, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, October 2003, Appendix IV, Table 3.

Exhibit 8: Cable Consumer Rates and Cash Flow Have Increased Dramatically Since Passage of the 1996 Telecommunications Act



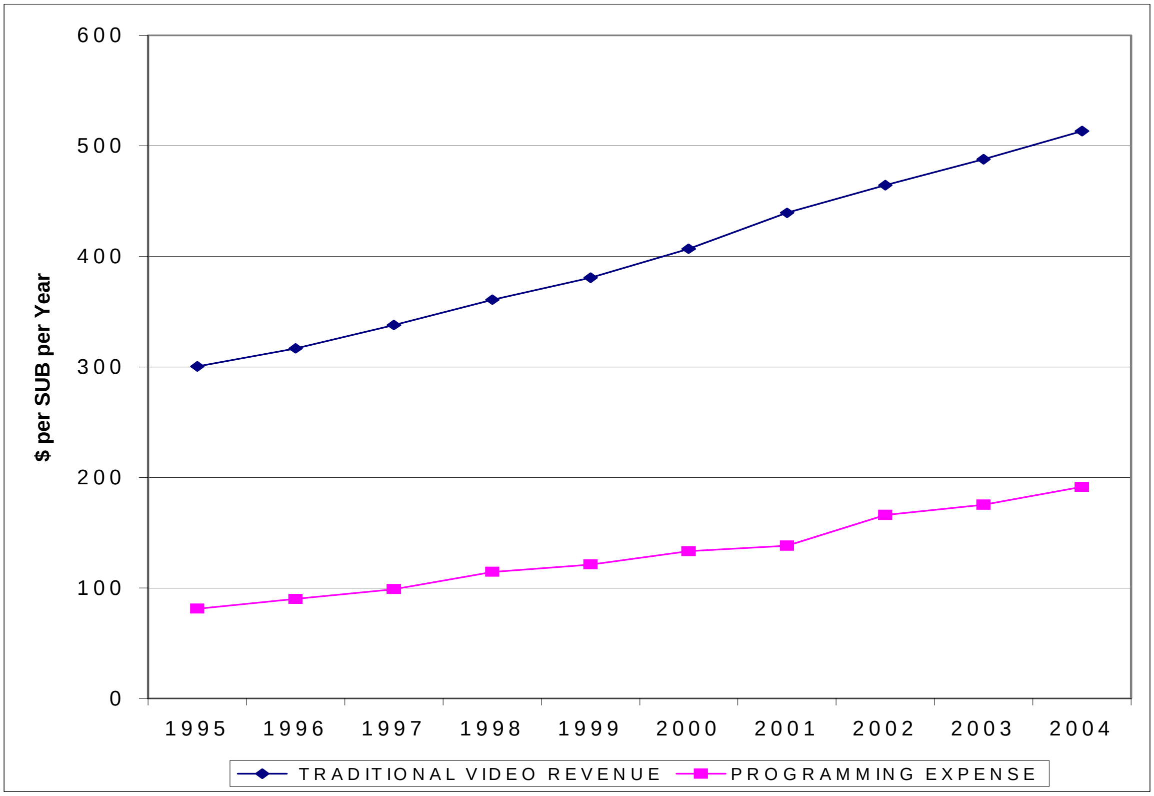
Source: Federal Communications Commission, *Annual Assessment of the Status of Competition in the Market for Video Programming*, various issues

Exhibit 9: Cable Revenue Has Grown Much Faster than Operating Costs



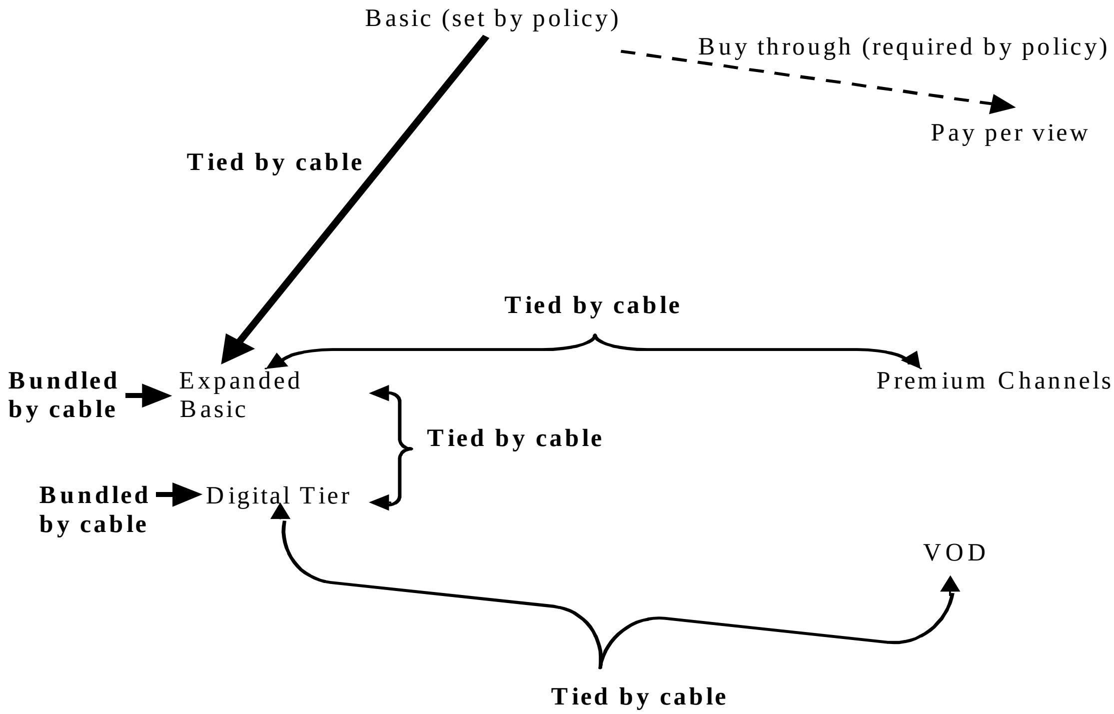
Source: Federal Communications Commission, *Annual Assessment of the Status of Competition in the Market for Video Programming*, various issues; National Cable and Telecommunications Association, *2005 Mid-Year Industry Overview*, p. 14 for program expense.

Exhibit 10: Traditional Video Revenue Growth Far Exceeds Growth in Programming Costs



Source: Federal Communications Commission, *Annual Assessment of the Status of Competition in the Market for Video Programming*, various issues; National Cable and Telecommunications Association, *2005 Mid-Year Industry Overview*, p. 14 for program expense.

Exhibit 11: The Cable Industry's Bundling and Tying Strategy



BUNDLED SERVICES

Service	Price/Month	Subs	Channels
Basic	$18	64m	16
Expanded Basic	$27	60m	54
Digital Tier	$16	26m	32

Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eleventh Annual Report,* MB Docket No. 04-227, February 4, 2005, p. 22; *In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment,* MM Docket No. 92-266, February 4, 2005, p. 12.

Exhibit 12: 29 of the 30 Top Channels, 1992-2004 Are Affiliated with a Broadcast Network of a Cable MSO

CHANNEL	1993 RANK SUBS	1993 RANK PRIME TIME	2003 RANK SUBS	2003 RANK PRIME TIME	2004 RANK SUBS	2004 RANK PRIME TIME	OWNER
ESPN	1	4	2	14	2	6	ABC/DISNEY
CNN	2	12	6	7	3		AOLTW
USA	3	1	5	4	4	3	LIBERTY
NICK	4	6	8	10	7	2	CBS/VIACOM
DISCOVERY	5	10	4	1	1	14	LIBERTY
TBS	6	2	1	5	4	10	AOLTW
TNT	7	3	6	3	3	1	AOLTW
CSPAN GROUP	8		3		8		CABLE
MTV	9	13	13	11	16	11	CBS/VIACOM
LIFETIME	10	7	8	12	10	8	ABC/DISNEY
TNN	11	11	11	13			CBS/VIACOM
FAMILY	12	8	15		14		ABC/DISNEY
A&E	13	9	130	8	9	15	ABC/DISNEY
WEATHER	14		14		10		
HDLN NEW	15				17		AOLTW
CNBC	16	18	18		19		NBC
VH-1	17	20	20		18		CBS/VIACOM
QVC	18	16	13				COMCAST
AMC	19	19	19				CABLEVISION
BET	20	14		19			CBS/VIACOM
WGN				9			LOCAL BCAST
CARTOON		5		6			AOLTW
SCI-FI	5	5		15			LIBERTY
TLC			16	12	13		LIBERTY
HISTORY				11	20	13	ABC/DISNEY
ESPN2			17		14		FOX
DISNEY				3		5	ABC/DISNEY
FOX NEWS				9		9	FOX
SPIKE					12		CBS/VIACOM
FX						12	FOX

Source: Federal Communications Commission, *Video Competition*, First and Tenth Annual Reports.

Exhibit 13: Program Suites of Firms with Carriage Rights Cover the Major Types of Expanded Basic Programming

	ABC	NBC	CBS	TW	LIBERTY	FOX	COMCAST
GENERAL	ESPN Lifetime	USA	NICK TNT	TBS	Discovery	Fox Sports	Regional Sports
NEWS	ABC news	CNBC MSNBC	CBS	CNN	BBC America	FOX News	Regional News
EMERGING MASS	Family	SciFi	TV Land	Court	Travel		Style
OLDER TRENDING	Bravo History A&E			TCM	Discovery Health Discovery Home	FMC	
YOUNGER TRENDING	Disney Toon Dis		Comedy MTV NickToons	TOON	Discovery Kids GSN	FX	Outdoor Life E! Sprout
EMERGING NICHE	LMN ESPN2 ESPN Class Soapnet	CMT VH1	BET Jazz Spike VH1 Class VH1 Count MTV2 MTV Espan MTV Hits Nick Gas Noggins	Oxygen	Discovery Military Science	Speed Nat Geog	G4 Golf TVOne

"Comments of American Cable Association," *Inquiry Concerning A La Carte, Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, MB Docket No. 04-207, July 12, 2004; Booz, Allen Hamilton, *The a la Carte Paradox: Higher Consumer Costs and Reduced Programming Diversity: An Economic analysis of the Implications of al la Carte Pricing on Cable Customers,* July 2004; Federal Communications Commission, *Video Competition*, Eleventh Annual Reports

Exhibit 14: Dominant Video Program Producers/Distributors

	Subscribers All		Subscribers Top 92		Writing Budget		Programming Expenditures		Production Share of Prime Time Hours in %
	# Million	%	#	%	$ Million	%	$ Million	%	
FOX/LIBERTY	1250	21	xxx	24	236	19	3803	9	3
AOL – TW	925	15	xxx	12	206	17	7627	18	10
CBS/VIACOM	910	15		16	145	12	9555	22	28
ABC/DISNEY	705	12		16	132	11	6704	16	21
NBC/Vivendi	720	12		9	159	13	3879	9	21
Subtotal	4315	75		77	772	72	31568	74	83
TOTAL	6000	100	xxx	100	1225	100	43212	100	100

SOURCES: Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CC Docket No. 00-132, Seventh Report, Tables D-1, D-2, D-3, D-6, D-7; *Television Market Report*: *2001* (Washington, D.C.: BIA Financial Network, 2001); Comments of the Writers Guild of America Regarding Harmful Vertical and Horizontal Integration in the Television Industry, Appendix A. Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy*, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; Bruce M. Owen and Michael G. Baumann, "Economic Study E; Concentration Among National Purchasers of Video Entertainment Programming," *Comments of Fox Entertainment Group and Fox Television Stations, Inc., National Broadcasting Company, Inc. and Telemundo Group, Inc., and Viacom,* In the Matter of 2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, Cross Ownership of Broadcast Stations and Newspapers, Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets, Definition of Radio Markets, MB Docket No. 02-277, MM Dockets 02-235, 01=317, 00-244, January 2, 2003; Federal Communications Commission, *Program Diversity and the Program Selection Process on Broadcast Network Television*, Mara Epstein, Media Ownership Working Group Study 5, September 2002, pp. 26.

Exhibit 15: Lack of Independent Programming Entry

Network	Launch	Owner
Cartoon Network	1992	MSO
Sci-Fi Network	1992	MSO
Turner Classic Movies	1994	MSO
Independent Film Channel	1994	MSO
WAM! Kidz Network	1994	MSO
Much Music USA	1994	MSO
Golf Channe	1995	MSO
Outdoor Life	1995	MSO
Great Amer.	1995	MSO
Animal Planet	1996	MSO
CNNFI	1996	MSO
CNNSI	1996	MSO
BET Jazz	1996	MSO
WE: Women's Entertainment	1997	MSO
Discovery Health Channel	1998	MSO
Tech TV	1998	MSO
Style	1999	MSO
Oxygen	2000	MSO
TV Land	1996	BROADCAST
Soapnet	2000	BROADCAST
Nat. Geog	2001	BROADCAST
ESPN 2	1993	BROADCAST
FX Network	1994	BROADCAST
History Channel	1995	BROADCAST
ESPN Classic	1995	BROADCAST
Fox News Channel	1996	BROADCAST
MSNBC	1996	BROADCAST
Speedvision	1996	BROADCAST
ESPNews	1996	BROADCAST
Fox Sports	1996	BROADCAST
LMN	1998	BROADCAST
Home & Garden	1994	BROADCAST
Food	1993	BROADCAST
Flix	1992	INDEPENDENT
Game Show Network	1994	INDEPENDENT
Bloomberg	1995	INDEPENDENT
Health	1998	INDEPENDENT
Goodlife	1998	INDEPENDENT
Ovation	1998	INDEPENDENT

Source: Sources: Joskow Paul, and Linda McLaughlin, "An Economic Analysis of Subscriber Limits," attached to Comments of AOL Time Warner In *The Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154. January 3, 2002, Table 2, Writers Guild of America. "Comments of the Writers Guild of America Regarding Harmful Vertical and Horizontal Integration in the Television Industry." Testimony before the Federal Communications Commission, *In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry Reexamination of the Commission's Cross-Interest Policy,* CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154., 2002; Federal Communications Commission, *Tenth Annual Report on Video Competition, 2004* Tables D-1, D-2, D-3.

Exhibit 16: Regional Markets are Dominated by Affiliated News and Sport Programming

	PERCENT OF ALL 94 REGIONAL NETWORKS		
	CABLE	BROADCAST	INDEPENDENT
NEWS	26	13	5
SPORTS	18	18	5
OTHER	0	0	15

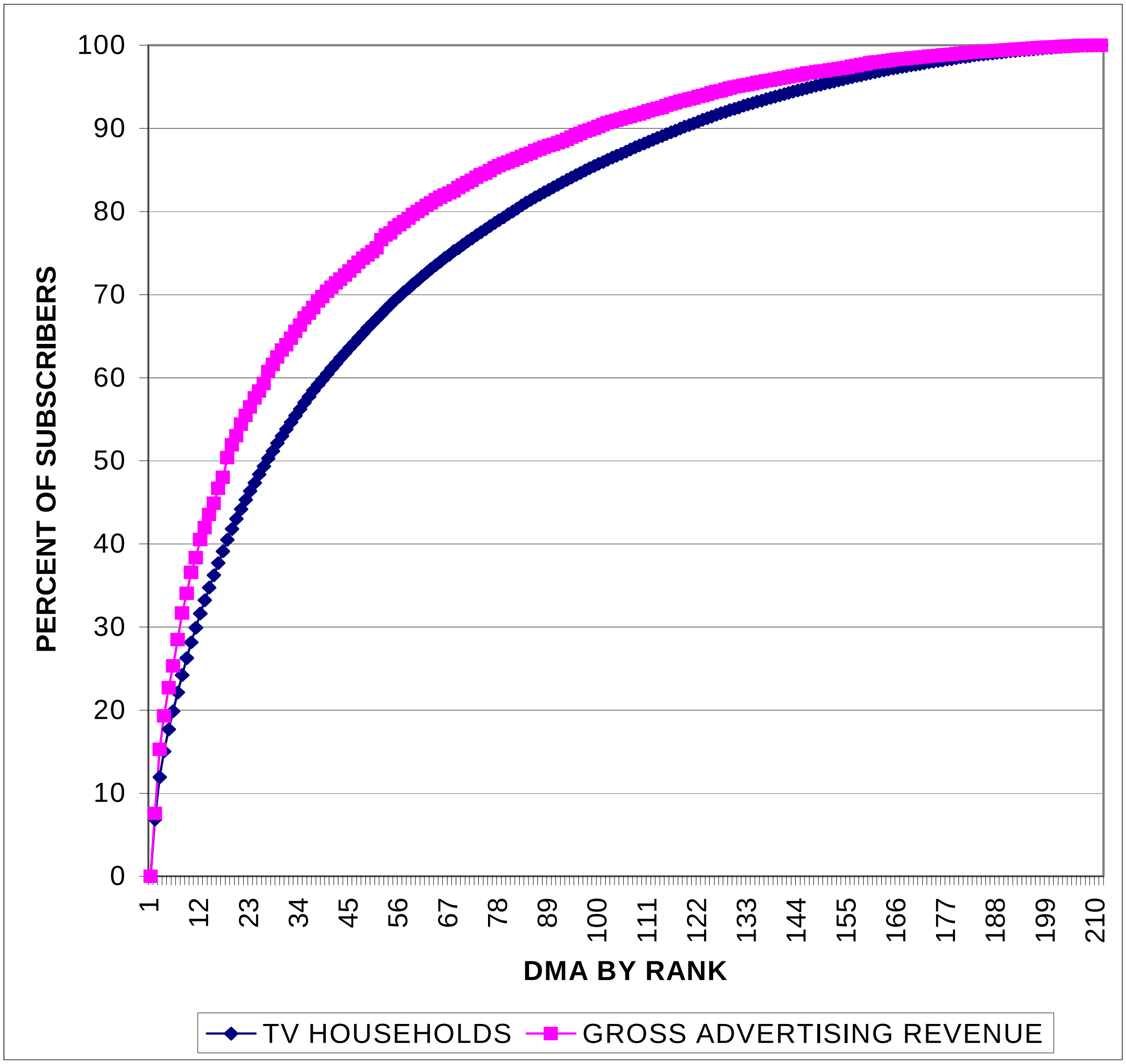
Federal Communications Commission, *Video Competition, Eleventh Annual Report*, Table C-4; National Cable and Telecommunications Association, *Industry Overview*.

Exhibit 17: Niche/Regional Programming Markets are Small and Dominated by Affiliated Entities

	Number of Networks	Total Subscribers	Average Subs/Net	Median Subs/Net
CABLE	25	120	4.8	2.5
BROADCASTERS	38	154	4.0	2.4
INDEPENDENT	58	108	1.8	.9

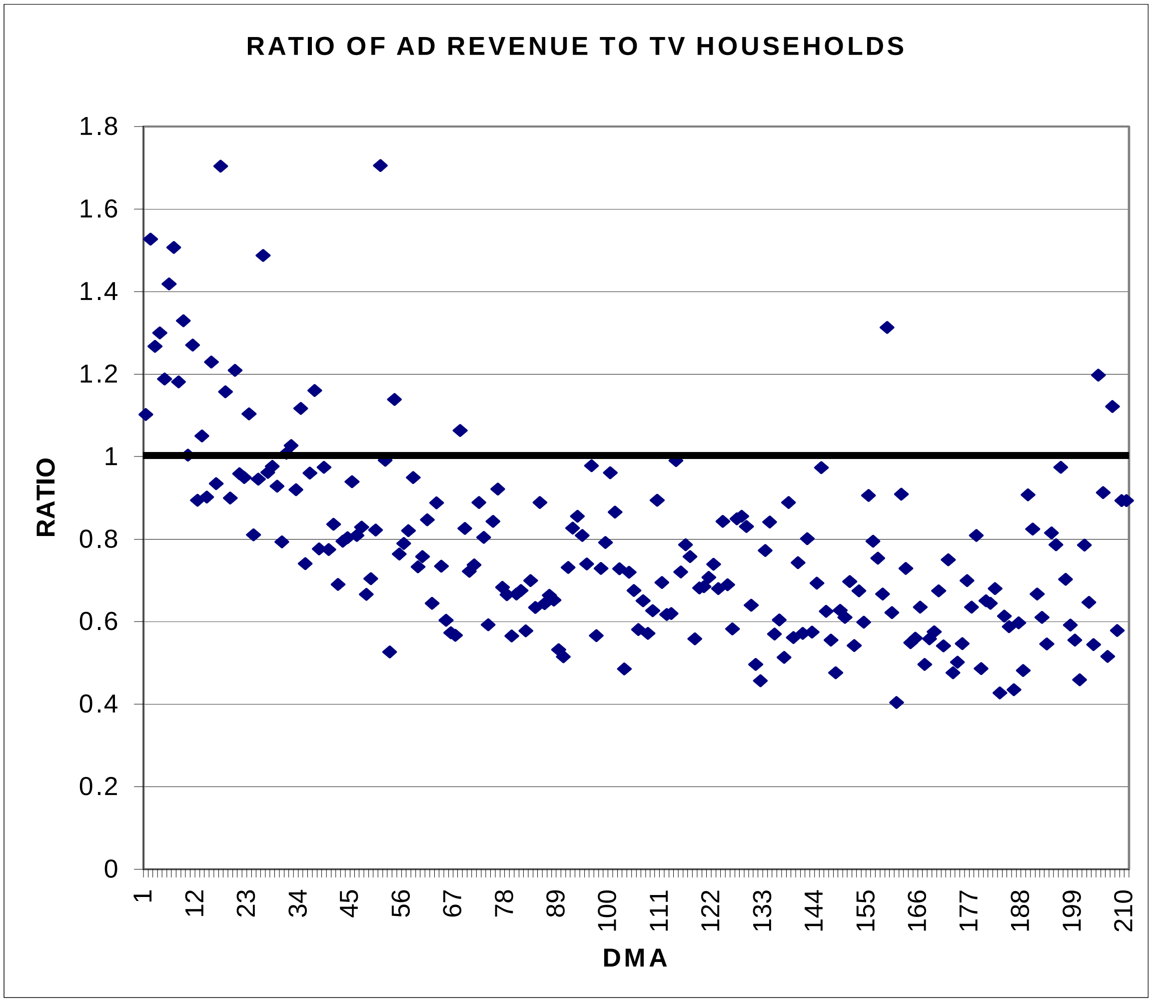
"The America Channel LLC's Petition to Deny," In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee, MB Docket No. 05-192, July 21, 2005 (hereafter TAC Petition), Exhibit 5; National Cable and Telecommunications Association, Industry Overview.

Exhibit 18: Ad Revenue is Skewed Toward the Top 25 DMAs



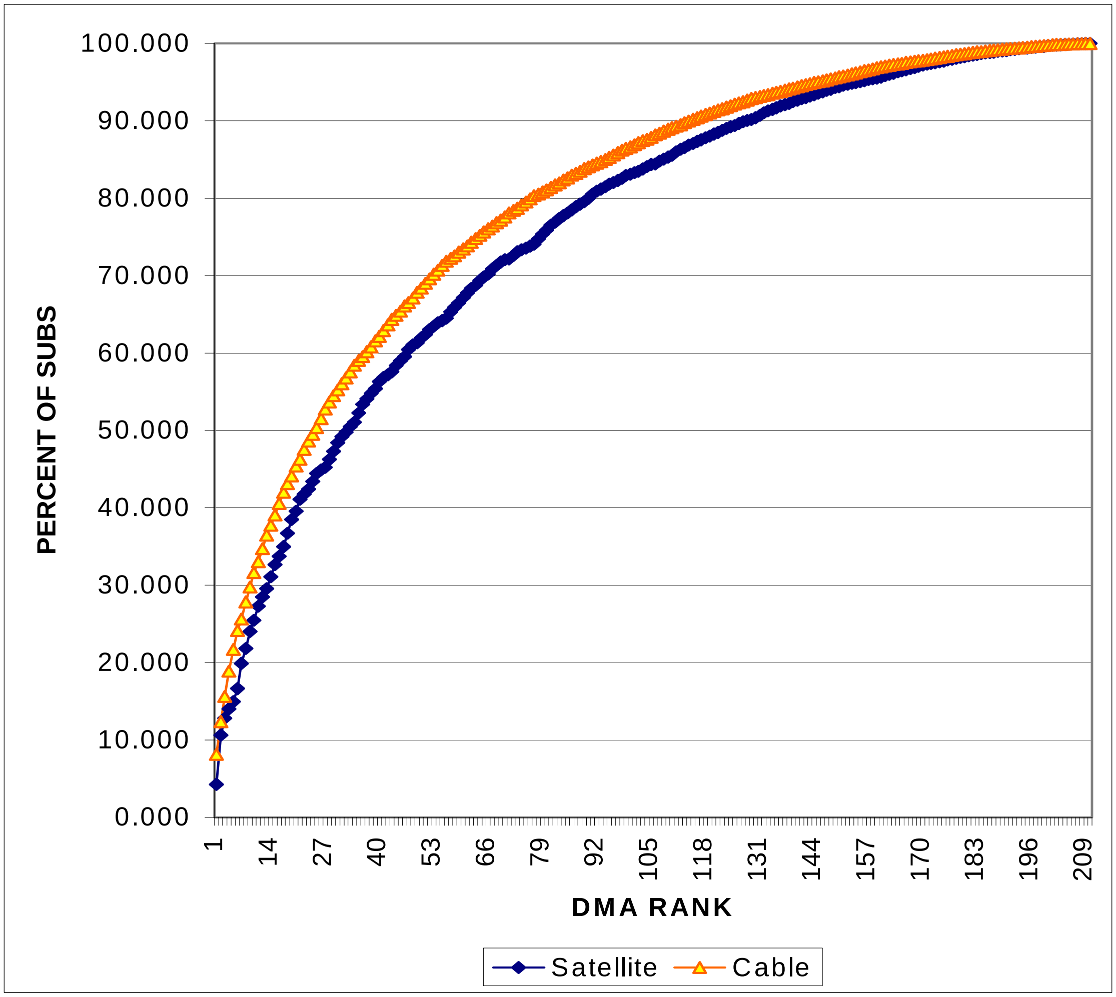
Source: BIA Financial, *Television Market Report Data Base, 2004*

Exhibit 19: Large DMAs Yield a Substantial TV AD Revenue Premium



Source: BIA Financial, *Television Market Report Data Base, 2004*

Exhibit 20: Satellite Has a Deficit in the Top 25 DMAs



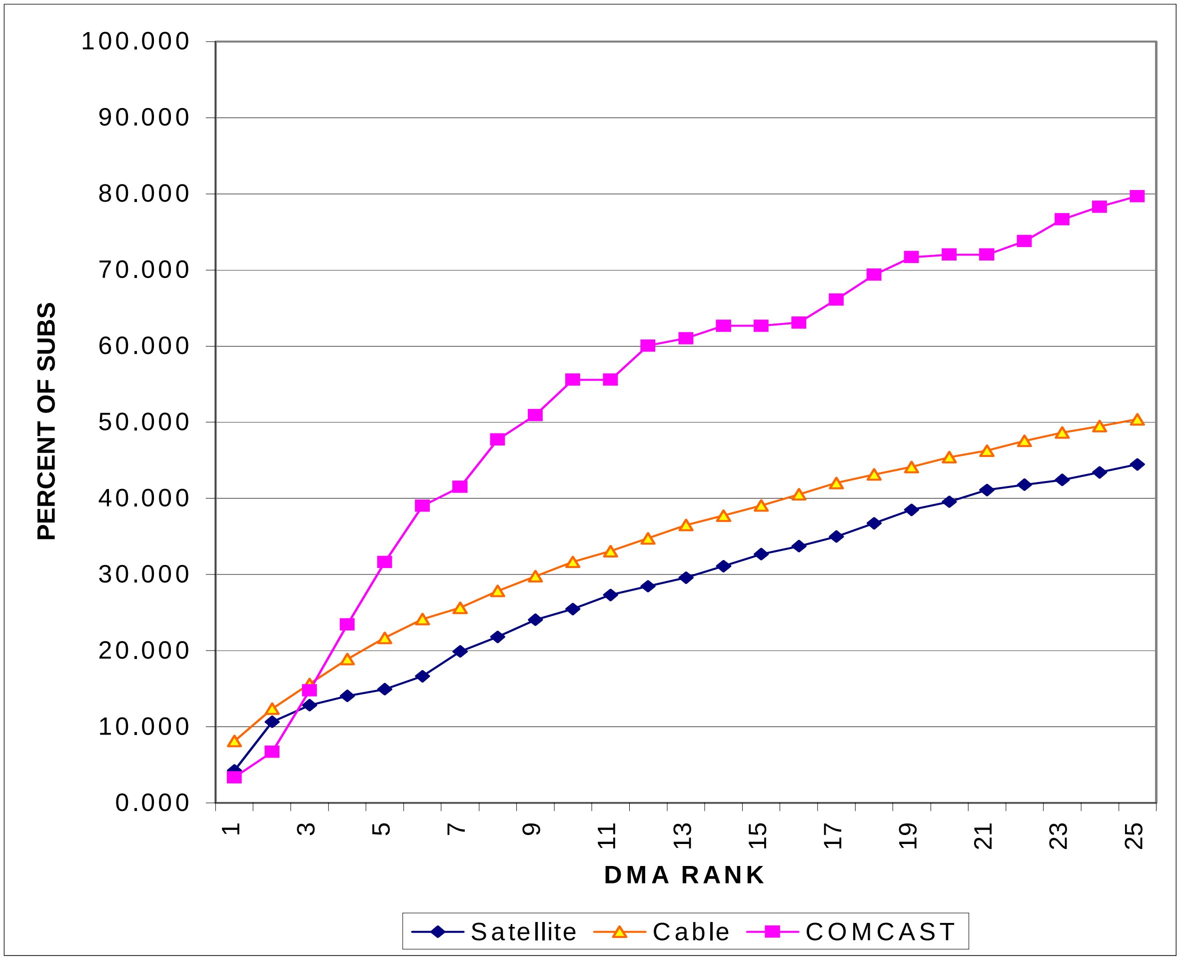
Source: Nielsen Media Research, February 2005.

Exhibit 21: Cable Market Power is Particularly Prevalent in Large Markets

DMA	CABLE SHARE	MVPD SUBS		CABLE SHARE	MVPD SUBS
DMAs WHERE CABLE HAS:					
LESS THAN 65% MARKET			**MORE THAN 65% MARKET**		
Springfield, MO	52	0.3	Zanesville, OH	84.20	0.03
Twin Falls, ID	53	0.0	Odessa-Midland, TX	84.27	0.12
Missoula, MT	53	0.1	Norfolk-Portsmouth-Newport	84.55	0.63
Idaho Falls-Pocatello, ID	55	0.1	Corpus Christi, TX	84.74	0.17
Meridian, MS	57	0.1	Chicago, IL	84.75	2.82
Paducah-Cape Girardeau	58	0.3	San Francisco-Oakland-San Jose	84.90	2.12
Chico-Redding, CA	58	0.2	Portland-Auburn, ME	85.19	0.36
Columbus-Tupelo-West Point, MS	59	0.2	Tampa-St Petersburg-Sarasota, FL	85.23	1.50
Boise, ID	59	0.1	Youngstown, OH	85.34	0.24
Columbia-Jefferson City, MO	59	0.1	Columbus, GA	85.48	0.19
Ottumwa, IA-Kirksville, MO	59	0.0	Dayton, OH	85.74	0.44
Duluth, MN-Superior, WI	59	0.1	Baton Rouge, LA	86.21	0.27
Sherman, TX - Ada, OK	59	0.1	Baltimore, MD	86.48	0.92
Salt Lake City, UT	60	0.6	Pittsburgh, PA	86.61	1.07
Quincy, IL-Hannibal, MO-Keokuk, IA	60	0.1	Syracuse, NY	87.33	0.35
Butte-Bozeman, MT	61	0.0	Rochester, NY	87.97	0.33
Jackson, MS	61	0.3	New Orleans, LA	88.13	0.59
Shreveport, LA	61	0.3	New York, NY	88.23	6.74
Joplin, MO-Pittsburg, KS	62	0.1	Harrisburg-Lancaster-Lebanon-York	88.32	0.63
Dallas-Ft. Worth, TX	62	1.8	Albany-Schenectady-Troy, NY	89.40	0.50
Tyler-Longview, TX	62	0.2	Laredo, TX	89.66	0.05
Wausau-Rhinelander, WI	63	0.1	Palm Springs, CA	90.53	0.13
Hattiesburg-Laurel, MS	63	0.1	Philadelphia, PA	90.87	2.63
Little Rock-Pine Bluff, AR	64	0.5	San Diego, CA	90.95	0.93
Albuquerque-Santa Fe, NM	64	0.5	Providence, RI-New Bedford, MA	92.42	0.57
Bangor, ME	64	0.1	Boston, MA	92.46	2.21
Terre Haute, IN	65	0.1	Hartford-New Haven, CT	93.12	0.95
Traverse City-Cadillac, MI	65	0.2	Springfield-Holyoke, MA	93.75	0.25
Great Falls, MT	65	0.1	Honolulu, HI	95.68	0.39
TOTAL MVPD SUBS					
TOP 28 SATELLITE v. TOP 28 CABLE		**6.9**			**28.12**
SATELLITE ABOVE 30% v. CABLE ABOVE 70%		**16.1**			**76.70**

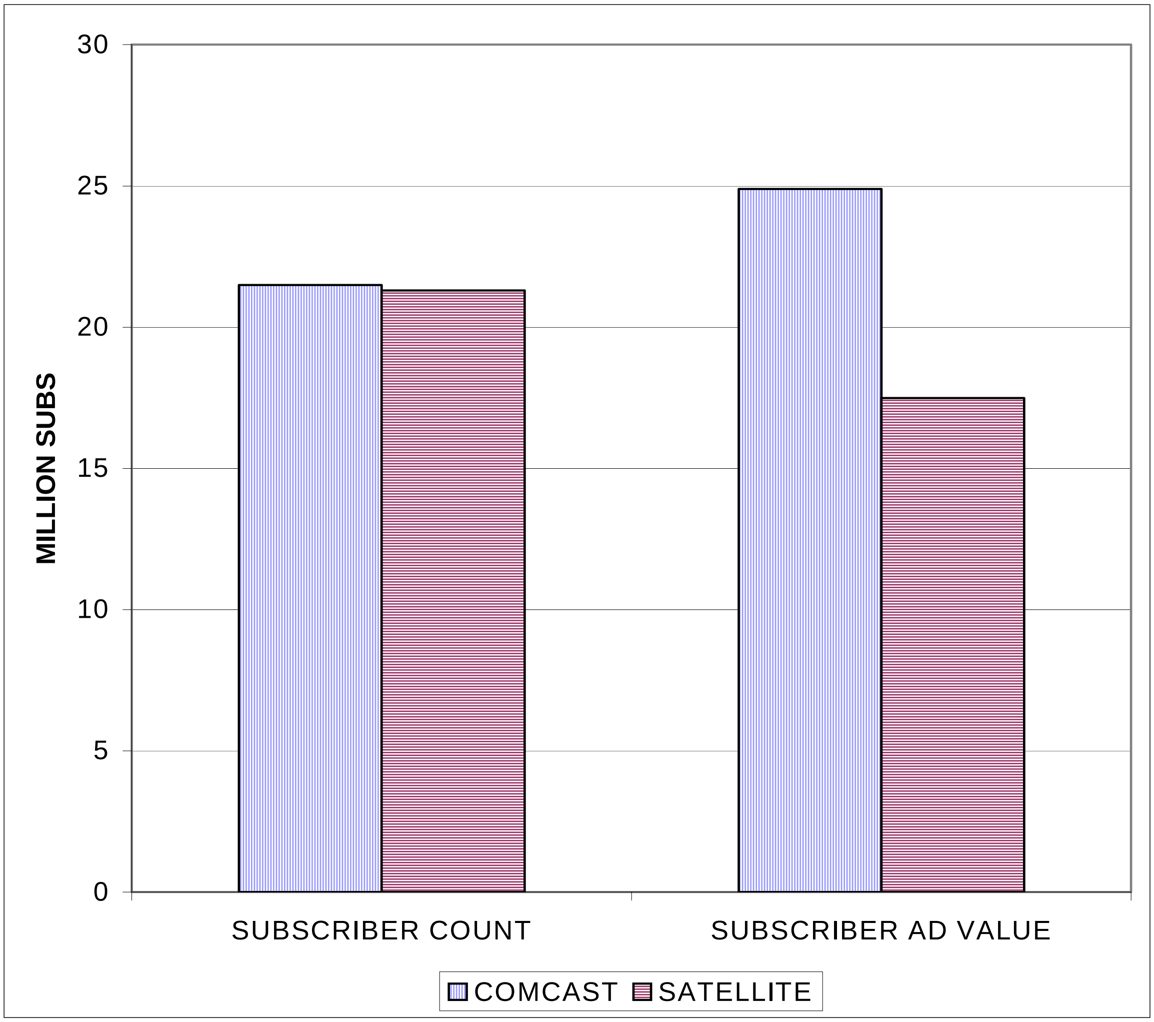
Source: Nielsen Media Research, February 2005.

Exhibit 22: Comcast Has a Huge Presence in the large DMAs Relative to All Cable and All Satellite



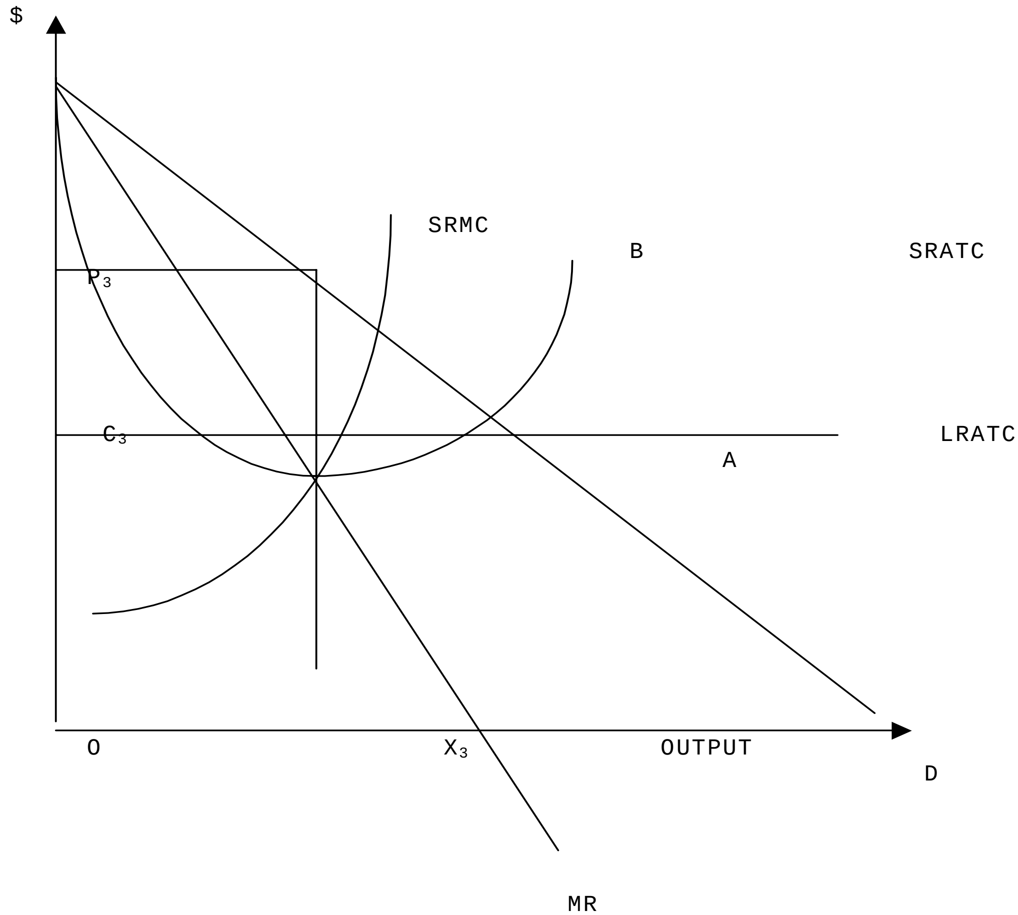
Source: Nielsen Media Research, February 2005; "The America Channel LLC's Petition to Deny," In the Matter of Application of the Consent to the Assignment and/or Transfer of Control of Licenses Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and Subsidiaries, debtors-in-possession), Assigners to Comcast Corporation (subsidiaries) Assignees and Transferees; Comcast Corporation, Transferor to Time Warner, Inc., Transferee; Time Warner, Inc., Transferors to Comcast Corporation, Transferee, MB Docket No. 05-192, July 21, 2005, Exhibit 1.

Exhibit 23: Comcast's Has a Huge Advantage as a Large DMA Cable Operator Compared to Satellite as a Small DMA/Rural Provider



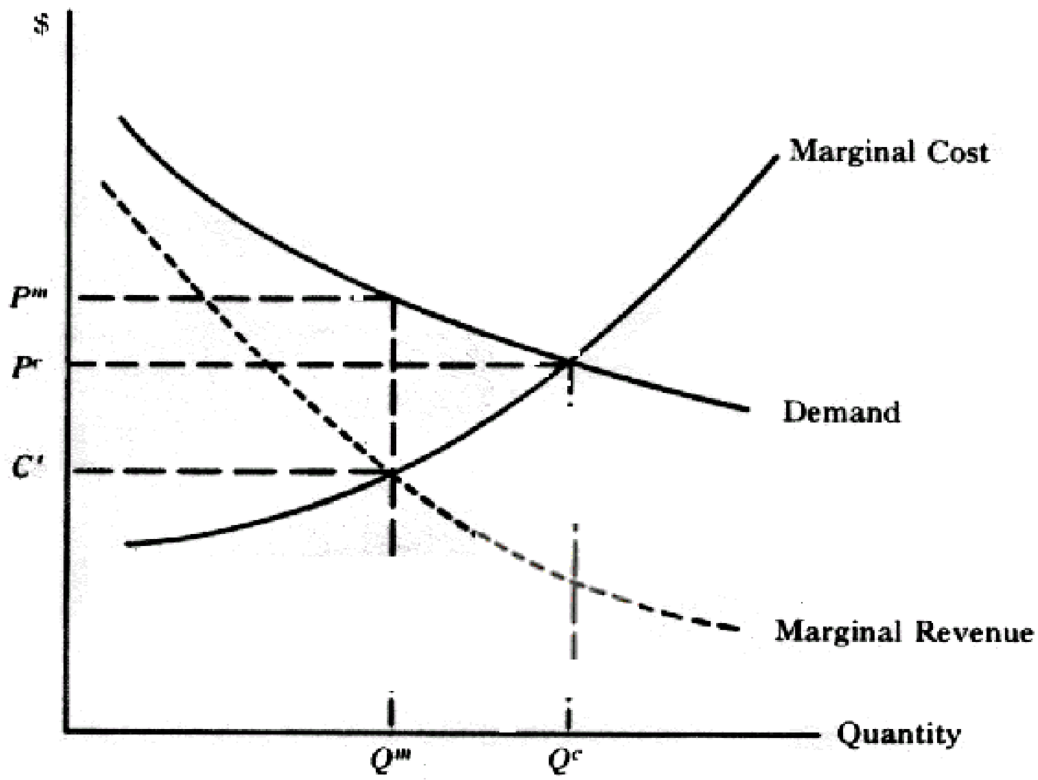
Source: See text, calculated by author.

Exhibit 24: Scherer And Ross On Monopolist Pricing



Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990, Third edition), pp. 21…22; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1997, Fourth edition), presents a similar view.

Exhibit 25: Landes And Posner On Lerner Index

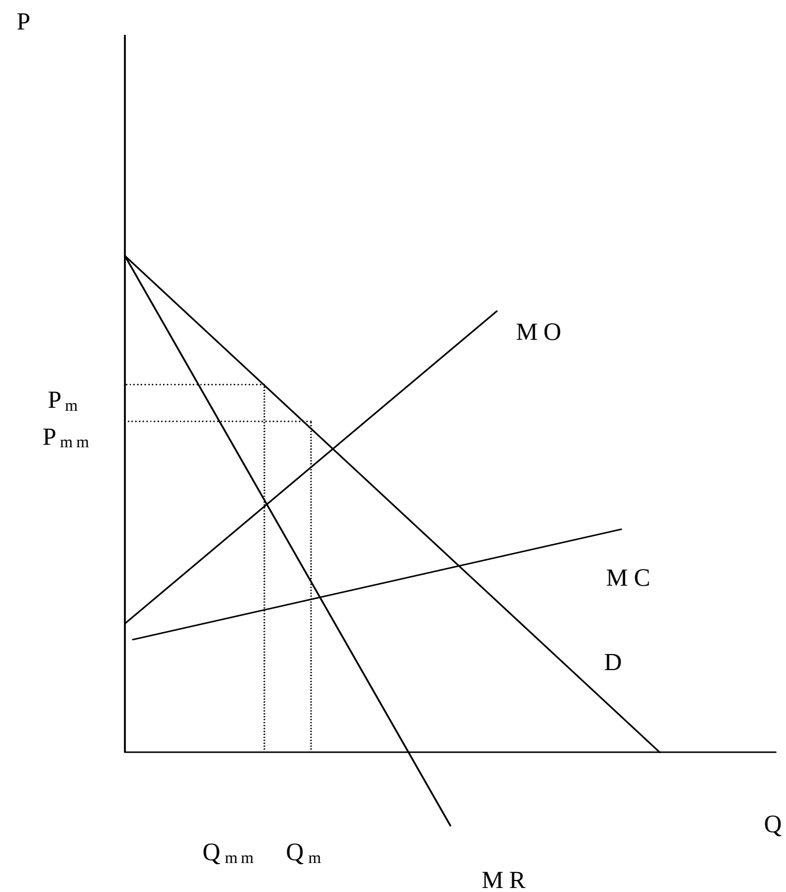


Monopoly vs. Competitive Pricing

FIGURE 1

Source: Landes, W. M. and R. A. Posner, "Market Power in Anti-trust Cases," *Harvard Law Review*, 19: 1981.

Exhibit 26: The Combination Of Monopoly And Monopsony Power



Reproduced from Hovenkamp, Herbert, *Federal Antitrust Policy: The Law of Competition and Its Practice,* Hornbook Series (West Group, St.Paul; 1999),Footnote 13, p. 15.